Since no concise analysis of the subject appears to have been undertaken previously, research should be useful in establishing how the problem of managing risk in property developments is tackled on a day to day basis by operators in the property market.

### 1.2.2. Limitations

There is a dearth of literature dealing with the format of this type of contract which means that the researcher is working in fairly "uncharted waters".

The unprecedented duration of the recent recession (1989 to 1994) has reduced the number of property developers active in the market which has consequently reduced the size of the sample for analysis.

The large capital cost of typical property development projects and the competition between developers for schemes, together with a need for confidentiality, resulted in players in the industry being reticent as far as answering questions was concerned. Many development agreements contain an entrenched confidentiality clause which legally precludes the signatories from divulging any of the contents of the document to outside parties. This presented a problem in obtaining access to the more current agreements. Also, it was possibly seen to be Strategically or tactically disadvantageous to "show one's hand" by disclosing the agreement usually used by an organisation to regulate the development process. Often the time pressure to sign such an agreement works in favour of the drafting signatory and this element of surprise would be lost if the particular agreement were too readily available to other operators in the property development industry.
The practicalities of enforcing rights arising out of development agreements are examined and it is an objective of the research that findings be produced to allow a checklist to be put forward for use by parties to property development projects. This would enable them to draft development agreements more effectively which in turn should enable them to manage the risks inherent in property development more efficiently.

The above objectives will be achieved by drawing on the writer's personal experience, through an examination of relevant literature on the subject and by means of a market survey. The survey, or field-work, takes the form of a questionnaire which was conducted by fax and by telephonic contact wherever possible.

1.2. Reasons for the research and possible limitations to the project

1.2.1. Reasons

Risks in property development are substantial and have significant financial consequences. They are experienced by all the players including the purchaser/owner, financier, developer, contractor and members of the professional team (e.g. architects, engineers, quantity surveyors, town planners and attorneys).

The extent to which these risks can be controlled and equitably distributed through the agency of the development agreement has not been specifically explored in any of the literature examined by the writer.

In view of the wide diversity of participants in the property industry, particularly those involved in property development, and because of the large capital cost of most property development projects with the concomitant high level of financial risk, any contract which assists in managing that risk should be of interest to the industry.
Chapter 1.
Introduction

1.1. Statement of the issue being investigated and of the overall objectives of the research report

The property development process is a complex one dependent upon the co-operation and co-ordination of many participants and upon the timeous flow of rights, skills, materials and money.

The process gives rise to numerous and varied risks which affect all participants in the process to some extent. These risks range from the impact of a delay arising from the simple non-delivery of materials to the more serious liability for the cost of rectifying structural defects in a building or the forfeit of development profits due to an inability to let the development as promised.

It is the right and natural instinct of all players in the development process to limit and attempt to avoid bearing responsibility for any unnecessary risks to which they might be exposed.

The issue investigated is thus the effectiveness of the property development agreement as a tool in managing the risks inherent in the property development process.

The research first examines the nature and extent of the risks generated by the property development process and the usual apportionment of liability for those risks among the various parties to a property development project.

It then assesses how risks may be shifted between the various signatories to a development agreement and examines how widely this form of contract is used by the industry at the moment.

The report gauges the property industry's perception of the necessity and usefulness of the development agreement and its application to individual respondents' businesses.
Chapter 4.
Market survey

4.1. Methodology

4.1.1. Aim of the research and structure of the questionnaire
4.1.2. Explanation of the sample and comment on response

4.2. Analysis of the actual responses to the questions

4.3. Conclusions drawn from the market survey

Chapter 5.
Conclusion

5.1. Summary of conclusions

5.2. Checklist for use in drafting property development agreements

5.3. Recommendations for further study

Appendices

Appendix 1. Sample Development Agreement
Appendix 2. Covering letter to questionnaire
Appendix 3. Questionnaire

References and Bibliography
Chapter 2.
Risks particular to each stage

2.2.1. Risks - Stage 1. - Concept/feasibility........................................ 36
2.2.2. Risks - Stage 2. - Land acquisition........................................ 37
2.2.3. Risks - Stage 3. - Design, cost and consent............................... 38
2.2.4. Risks - Stage 4. - Financing.................................................. 40
2.2.5. Risks - Stage 5. - Construction............................................... 45
2.2.6. Risks - Stage 6. - Letting.................................................... 47
2.2.7. Risks - Stage 7. - Management and ownership.............................. 48

Chapter 3.
How effective are existing property development agreements?
An examination of a typical existing development agreement

3.1. Distinction between "standard" clauses, and the "essential" clauses appropriate to the allocation of risk in the property development process.................................................. 49

3.2. An evaluation of the risks managed by a sample development agreement.................................................. 52

3.3. Parties protected and those left vulnerable by the sample development agreement.................................................. 55

3.4. Effects of the power and of the relative positions of strength of the parties to a development agreement.................................................. 87

3.5. Enforcement of rights arising out of property development agreements.................................................. 90

3.5.1. What are the usual methods of enforcement?.................................................. 90
3.5.2. How practical are these methods?.................................................. 91
3.5.3. How cost effective are these methods?.................................................. 91

3.6. Typical shortcomings in existing development agreements.................................................. 92
# Contents

<table>
<thead>
<tr>
<th>Declaration</th>
<th>ii</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abstract</td>
<td>iii</td>
</tr>
<tr>
<td>Disclaimer</td>
<td>iv</td>
</tr>
<tr>
<td>Dedication</td>
<td>v</td>
</tr>
<tr>
<td>Acknowledgements</td>
<td>vi</td>
</tr>
<tr>
<td>Contents</td>
<td>vii</td>
</tr>
</tbody>
</table>

## Chapter 1.

### Introduction

1.1. Statement of the issue being investigated and of the overall objectives of the research report ........................................ 1

1.2. Reasons for the research and possible limitations to the project ......................................................................................... 2

1.2.1. Reasons .................................................................................................................................................................................. 2

1.2.2. Limitations .............................................................................................................................................................................. 3

1.3. Overview ...................................................................................................................................................................................... 4

1.3.1. Chapter 2 .................................................................................................................................................................................. 4

1.3.2. Chapter 3 .................................................................................................................................................................................. 4

1.3.3. Chapter 4 .................................................................................................................................................................................. 5

1.3.4. Chapter 5 .................................................................................................................................................................................. 5

1.4. Sources of data .................................................................................................................................................................................. 5

1.5. What is a property development agreement and what is its application in the property development process? .................. 6

1.5.1. Description ................................................................................................................................................................................. 6

1.5.2. Current legal status .................................................................................................................................................................. 7

1.5.3. Application .................................................................................................................................................................................. 8

## Chapter 2.

Why is a property development agreement necessary? - An analysis of the risks inherent in the property development process

2.1. Stages in the development process .................................................................................................................................................. 10
Acknowledgements

I would like to thank the following people for their assistance in carrying out the work in preparation for this discourse:

Professor Ronnie Schloss  Head of the Department of Building, Faculty of Architecture, University of the Witwatersrand

William Midgley  Director, Edward Nathan and Friedland Inc.

Professor J. Morris  PPC Professor of Building Science, Department of Building, Faculty of Architecture, University of the Witwatersrand
to Lara
Disclaimer

The information and opinions contained herein have been obtained in good faith and from sources which and persons whom I believe to be reliable, but no representation or warranty, express or implied, is made as to their accuracy, completeness, correctness or otherwise and I accept no liability whatsoever for any direct, indirect or consequential loss arising from the use of this document or its contents.
Abstract

This research report analyses the effectiveness of the property development agreement as a tool in managing the risks inherent in the property development process. It incorporates an examination of a sample property development agreement and draws conclusions from market research conducted by means of a questionnaire.

In Chapter 1 the property development agreement is defined. The necessity for such an agreement is examined in Chapter 2 by identifying and describing the various stages of the property development process and by establishing the risks inherent in each stage.

Chapter 3 comprises a critical review of a typical existing development agreement. In this chapter a distinction is drawn between the "standard" clauses and those "essential" clauses which are instrumental in the allocation of the risks in property development. The agreement is then evaluated as a risk management tool and the ancillary topics of establishing those parties protected by and those left vulnerable by the agreement, the effects of the power and relative positions of strength of the signatories and the enforcement of the rights arising out of property development agreements are explored. Finally, this chapter looks at some typical shortcomings of development agreements.

The methodology behind the market survey is explained in Chapter 4, the responses of the sample of 50 property industry operators are analysed and conclusions are drawn from the answers to the questions posed.

Chapter 5 concludes that property development agreements do exist, are necessary and are useful in creating certainty with regard to rights and obligations flowing from the property development process and that they are valuable in ensuring that risks are allocated as the parties intended they should be.

This chapter also contains a checklist of items to be aware of when drafting a property development agreement and details some recommendations for possible further studies in this field.
Declaration

I declare that this research report is my own, unaided work. It is being submitted for the degree of Master of Science (Building) in the specialised field of property development and management at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination at any other University.

__________________________

___________ day of ________________ 1995
MANAGING RISK THROUGH THE PROPERTY DEVELOPMENT AGREEMENT

Alexander James Calder

A research report submitted to the Faculty of Architecture, University of the Witwatersrand, in partial fulfilment of the requirements for the degree of Master of Science in Building

Johannesburg, 1995
2.1.1. Stage 1 - Concept/Feasibility

Projects often begin with an idea generated by a developer or property broker as a result of his intimate working knowledge of a particular location. A broker whose daily business extends over a defined geographic location may be aware that a major lease on some old premises is about to expire, or that a piece of land is due to be auctioned off by the State or out of an insolvent or deceased estate.

The broker would also be aware of any increasing demand for a specific sort of premises in the area. Premises may be either commercial (offices), industrial or retail or even residential.

On the other hand, a company may have had an enquiry from a company seeking office space in a particular area or a manufacturing concern looking for a factory on a specific site. He may have identified a shortage of rental accommodation in a suburb and sense a demand for apartments to rent.

The developer could just as easily be a landowner who recognises that his suburb is being rezoned for offices, or a town planner, architect or quantity surveyor who in the course of his business identifies an opportunity to change or improve the usage of a property which includes land and any buildings or improvements which might exist on that land.

The concepts described above are all of a speculative nature and it should be borne in mind that there is a whole range of property development projects which are not speculative and consequently only experience a limited segment of the full spectrum of risks that would be generated by a speculative development project.
"Commitment" refers to the undertaking to provide lettable space of a particular quality to a specific tenant for occupation on an agreed date.

"Implementation" is the project management and construction phase of the scheme which carries a significant portion of the overall risk in the project. Once construction has commenced it is far harder for the developer to restructure the scheme and it will be focusing on the timeous completion of the project, the quality of the building work and ensuring that the construction comes in under budget.

Many of the risks attaching to this stage such as "extreme weather conditions, strikes or major shifts in the local, national or international economic conditions" are beyond the control of the developer.

The final stage (i.e. "Let, manage and dispose") as identified by Cadman and Crowe is also a most important one in which the developer's profit can be quickly and entirely eroded depending upon the structure of the development transaction and drafting of the development agreement. The point in time at which the scheme is fully let determines the extent of the risk that the developer will continue to bear and has an equivalent effect on any return he may receive from the scheme.

As observed previously, there are many similarities in the stages as identified by different individuals and those isolated by the writer are in the same vein as the two interpretations above.

The seven relevant stages drawn from readings and identified by the writer from his own experiences and research which will be used for the purposes of this study are as follows:
would be tested to establish the need/demand for such use by means of a demographic survey.

Initiation is followed by "Evaluation" where an initial feasibility study is undertaken. This would include establishing the cost of the scheme, its likely return and the physical characteristics as well as the capabilities of the site. Any legal constraints applicable to the site would be identified at this stage and to this end a number of consultants and professionals would be employed.

"Acquisition", the next stage, encompasses securing rights to the land and arranging finance which usually has two legs, firstly short term "bridging" finance to cover the cost of construction which is followed by longer term funding to enable the developer to retain the scheme as an investment. In terms of this definition of the "acquisition" stage, financing could also mean placing the entire development with a long term owner such as an Institutional Investor.

The "Design and costing" stage comprises the drafting of detailed plans, drawings and specifications. A Bill of Quantities would also be generated at this point and consultants would be used extensively.

"Permissions" is a complex stage of the procedure and is particularly involved in the UK where a lot of development centres around the demolition of existing buildings owing to the shortage of raw land for "green-fields" developments. Nevertheless, even in South Africa time has to be allowed and expenses budgeted for complying with town planning regulations regarding physical aspects of the site and any servitude conditions. Also, possible appeals to Provincial bodies where permission is denied by a local authority are handled at this stage. In addition, calculations of any "betterment" payable to the local authority pursuant to the rezoning of a site would be made during this stage.
"M" The maturing process - This is usually the second decade of a building's life which would commence when the area all around the subject property is developed and established. Because the building is entering a phase in which certain components of the building (e.g. heating and air-conditioning systems) may be in need of major replacement, the investor would require a high cash flow in order to enable him to achieve the return on his investment more quickly and to compensate him for the increased risk of the premises depreciating in value over the period and for the shorter remaining life of the structure.

"A" The ageing process - This stage occurs when running costs are high and rising and the physical condition of the building is deteriorating without hope of a reprieve. The only investors likely to look at the property would be those with an eye to partially revamping or completely refurbishing the premises in order to take the scheme back to an earlier stage in the life cycle.

"D" The demise - This is the point at which the building's condition has deteriorated to such an extent that it can no longer be used to generate income and must be demolished. Any purchaser at this stage would calculate the cost of demolition and removal of rubble before subtracting it from land values prevailing in the area to arrive at an undervalued land value.

For the purposes of this study only the stages contained in the "upside" of the pyramid are relevant and compare broadly with the analysis of the English authors, David Cadman and Leslie Austin-Crowe (Cadman & Crowe, 1991).

These writers begin with "Initiation" which involves finding a suitable site to match a required use or vice versa. The market
with his money, the lower the risks and consequently his return will be proportionately lower.

Once the property has been fully let it is at the top of the "stage" pyramid. From this point on, as time passes, the capacity of the building to generate rental will diminish. It is quite likely that there will be periods of improved performance due to increased demand for space in the building which could come about as the result of an improvement in external factors such as other buildings and facilities being erected in the same location. Eventually though, the building will reach the end of its useful life and after reaching a point at which either functional or physical obsolescence renders the underlying land value or the value of another new development on that site greater than that of the existing improvements, the building will be demolished to make way for a new development.

Seldin & Swesnik have identified a further four stages which occur during this declining phase and they are:

"A" Absorption - This stage usually lasts for around ten years and is the period during which no substantial parts should have to be replaced in the building. It has also been referred to as the "time during which the real estate market is absorbing the new construction of competitive buildings in the area where your building is located". The argument is that from the moment it is commissioned, a building begins to deteriorate and lose value. This process is accelerated by the commissioning of competing buildings in the neighbourhood and unless building costs increase at a rate faster than inflation it is the land which appreciates in value and not the building itself. This is the result of a general improvement in the location.

The point to be noted here is that it is the physical structure that declines in value and not necessarily the value of the development as a whole.
Chapter 2.
Why is a property development agreement necessary?
An analysis of the risks inherent in the property
development process.

2.1. Stages in the development process

There have been a number of attempts to identify the stages in the
development process and whilst the basic process is the same, the
way the stages are defined appears to depend upon the property
practices which have evolved in a particular geographic area.

For example, two American writers, Maury Seldin & Richard
Swesnik (Seldin & Swesnik,1970), have used the acronym
"GLITAMAD" to summarise the various stages. To summarise
briefly, their understanding of the stages is as follows:

"G"  Ground floor which involves the preparation of a
"mortgage package" for presentation by the developer to
the financier or investor and includes a plan, feasibility
study and market research.

"L"  Loan commitment stage at which a decision is taken by
a financial institution to finance the project. In this
scenario the developer remains the owner of the scheme
until such time as he is able to find a buyer.

"I"  Interim processes i.e. arranging short term or "bridging"
finance and negotiation of the building contract.

"T"  Tenancies or letting of the scheme.

The above four steps represent the upside of the development
"stage" pyramid and the point at which the investor commits himself
to the project will largely determine the extent of the return he is
likely to enjoy from the investment. The later the investor comes in
The investor would first ensure that the scheme suited its particular investment criteria in terms of size, location, use, design and aesthetic considerations and would check that the necessary finance was in place to pay for the scheme, finally it would see to it that the initial return was able to be secured by an appropriate mechanism such as a rental guarantee or headlease.

Development agreements are often, but not always signed before any construction work is commenced, however, if construction has begun it would be at the developer's own risk until an agreement was concluded.

Property development agreements are generally prepared by attorneys on behalf of developers or investors and given the detailed nature of the transactions agreed upon usually take many hours of work and result in fees amounting to several thousands of rands.

This often puts the negotiation, drafting and signing of such agreements beyond the reach of smaller developers and as seen in question 3 of the questionnaire the majority of the sample of respondents are involved in development schemes with a minimum value of between R5 million and R20 million.
or trust the signatory must have a resolution from the board of directors or trustees authorising him to sign on behalf of the company or trust and enabling him to legally bind the company or trust to the terms of the contract.

1.5.2.2. The specific parties to the contract must be determined. If, for example, one of the parties is a partnership then full details of all the other partners must also be disclosed.

1.5.2.3. The material terms of the contract must be agreed, i.e. the nature of performance to be effected by the parties and the contract sum to be paid.

1.5.2.4. If the parties have agreed that the agreement is to be reduced to writing, then the agreement must be signed by both parties in order to communicate acceptance of the terms of the arrangement.

1.5.2.5. There should be no misrepresentation by any of the parties or the contract could be voidable.

1.5.2.6. Performance must be physically possible.

1.5.3. Application

Typically, a property development agreement would be entered into once the developer had secured some rights to the site such as an option to purchase and after the Investor had satisfied itself that the scheme was financially viable given the price agreed with the developer.
guarantees from the investor, performance guarantees, tenant layouts, an indicative tenant mix schedule and letters of intent from major tenants, an interest calculation clause and a schedule setting out the rental guarantee calculation.

1.5.2. Current legal status

If the development agreement contains a contract of sale of land, then in terms of section 2 (1) of the Alienation of Land Act 68 of 1981, the material terms of that agreement must be recorded in writing and signed by the parties thereto or by their agents acting on their written authority.

Equally, if the agreement contains a contract of suretyship between some of the parties then it must also be reduced to writing and signed by the sureties. Otherwise, the agreement may be verbal or in writing. However, due to the wide range of issues to be agreed upon and the scale of the potential financial damages which might be suffered if a point of agreement is not clearly recorded, this agreement is invariably reduced to writing.

The following basic principles of the law of contract should be borne in mind when entering into a property development agreement (these principles are not intended to be exhaustive and are described merely to indicate the primary considerations):

1.5.2.1. The parties must have the necessary legal capacity to sign the agreement. This is important where one or more of the parties is a company, institution or other form of legal person. For example in the case of a company
1.5. What is a property development agreement and what is its application in the property development process?

1.5.1. Description

A property development agreement is a contract entered into between the developer of and the investor in a particular property development project.

On the one hand, the document is designed to set out, unambiguously, the obligations of the developer with regard to: securing the appropriate rights for the land, timeous and proper construction of the buildings as described to the investor in the marketing or sales documentation and most importantly, securing any initial return which the developer has guaranteed to the investor.

On the other hand, the agreement is also intended to protect the developer and should include a detailed schedule of what he is to be paid, when and against what performance. It should also provide some sort of dispute resolution mechanism to enable matters of fact called into question to be settled objectively by an independent and appropriately qualified arbiter who will not be influenced by the will of either the developer or the investor.

In the interests of certainty, a development agreement is likely to contain copies of some or all of the following annexures: land sale agreements, building contracts, contracts with consultants (e.g. architects & engineers), design documents (drawings), building specifications, a specimen lease, zoning certificates, copies of title deeds, the financial feasibility study with a schedule of anticipated rentals and operating costs, proof of insurance, a bill of quantities and any other costing information, a statement of the method of measurement of rentable space, bank
Finally, the typical shortcomings of existing development agreements are critically assessed in this chapter.

1.3.3. The findings of the market survey are analysed in Chapter 4 in order to test the property industry's views on the property development agreement.

This chapter includes a statement on the methodology of the market survey which covers the aim of the research and structure of the questionnaire as well as an explanation of the population sample used and a comment on the response received.

It contains the analysis of the actual responses to the questions and finally summarises the major conclusions from those responses.

1.3.4. In conclusion, Chapter 5 contains a statement on the usefulness and need, if any, for a development agreement in the property development process and a summary of the most important rights and obligations to be included in a development agreement in the form of a checklist for use by the industry. It also contains some recommendations for further study on the subject.

1.4. Sources of data

Data has been obtained from literature, through the practical experience of the writer and from information collected from operators within the property development industry through a process of interviews and written enquiries. A bibliography and copy of the questionnaire are included as appendices.
Finally, parties have incurred extensive legal costs in having had development agreements drafted by their own attorneys and consequently are reluctant to lay them open for inspection.

1.3. Overview

1.3.1. In order to establish why a property development agreement is necessary, Chapter 2 will examine the risks inherent in property development firstly by defining the stages in the process and secondly by establishing the risks particular to each stage.

1.3.2. To establish the effectiveness of property development agreements in managing those risks identified in Chapter 2, Chapter 3 contains an examination of a typical, existing development agreement specifically focusing on the distinction between the "standard" and "essential" clauses in the sample agreement. An evaluation of the risks covered by the sample agreement and identification of the parties protected or left vulnerable by the agreement is also undertaken at this stage.

In addition, the effect of the power and the relative positions of strength of the signatories to the agreement on the negotiation process leading to conclusion of the contract is investigated.

Chapter 3 also examines the enforcement of existing development agreements. This includes answers to questions such as: how practical is the enforcement of the rights of the respective parties, how cost effective is enforcement of the contract and what are the usual methods of enforcement?
However, if the developer still needed to find an investor for the scheme he would probably endeavour to get the professionals to work on a contingency basis (i.e. they would only be paid if the scheme is built) and they would concentrate on producing information to be contained in a sales brochure and presentation to potential investors.

The first step in the design phase would be to select a suitable architect or firm of architects. It would most probably be one with an established track record of designing buildings with a use similar to that of the proposed development. The developer needs to decide clearly on the exact nature of the brief he intends giving the architect. His decision will be based on his own skills and level of experience as well as the nature of the purchaser he has in mind for his scheme.

Whilst it is naturally cheaper simply to employ the architect to design the structure and produce working drawings approved by the local municipality, a full brief goes much further and includes project management and the responsibility and legal liability for the physical integrity of the completed structure.

Experienced and astute investors should be aware that a developer may attempt to minimise costs by paying the architect a reduced fee for the design work only, thereby excluding responsibility for the whole project and future integrity of the structure. Such investors should insist on the full services of the architect being retained to ensure correct quality control and the extra legal protection of the architect's professional indemnity insurance. This insisting on the full services is often only possible where the scheme has been "on-sold" to the investor well before construction is completed. The reason for this is that once construction is well under way or completed, the architect is most unlikely and would be most unwise to
can only be distributed by way of "liquidation" dividends without incurring STC regardless of when the capital profit was realised. In other words, a company or close corporation would have to be liquidated to avoid the payment of STC on the subsequent distribution of profits to the shareholders.

Typically developers charge management fees to their development vehicles in order to extract their profits without paying divisible taxation (i.e. both the marginal corporate rate and STC). Only where a development company is highly profitable and has ongoing development activity might it be worth not liquidating it on the sale of a completed project, otherwise liquidation will be the order of the day to avoid unnecessarily paying STC.

It is thus evident that there are a number of risks inherent in the land acquisition stage which may be regulated by forward planning, the proper consultation of professionals and by establishing the correct vehicle for holding the development project.

2.1.3. Stage 3. - Design, cost and consent

This paragraph is prefaced by the observation that the amount of input from the professional team depends upon the nature and progression of the development. If an investor has been found or the developer intends retaining ownership then the professionals would be contracted with and would begin their work in earnest with the intention of minimising the time to construction because the finances were in place and time would have a cost implication. They would also be earning a fee most of which would be payable on completion of the work.
applies if the parties to the transaction agree in writing that the enterprise is sold as a going concern. The parties also have to agree in writing that the enterprise will be an income-earning activity on the date of transfer. Finally, the amendment states that “the assets which are necessary for carrying on the enterprise” must be disposed of by the seller to the purchaser. From this one may conclude that it is not necessary to dispose of all the assets of the enterprise (Rodrigues, 1995).

If the purchaser pays VAT at the standard rate it will depend on the purchaser’s own VAT status, (i.e. registered vendor or not) as to whether or not it will be able to claim an input credit for the VAT paid. Also if the purchaser earns more than R150 000.00 per annum in rentals etc. it will have to register as a vendor.

Only registered VAT vendors are entitled to claim input credits and even non tax-paying bodies such as property trusts, pension funds and life offices would be able to claim a full VAT input credit on property purchases provided they are registered vendors.

Where the property is held in a company and a purchaser elects to acquire that company, the purchaser would pay stamp duty on the value of the shares, but not on the value of any loan account. No transfer duty would be payable nor would the transaction attract the payment of VAT unless it was a shareblock company and even then VAT would only be payable on the “block” of shares where they are purchased from a developer.

A further tax consideration is the requirement that STC of 25% be paid on any dividend paid by a company or close corporation. STC is only payable in the case of companies and close corporations and has an important consequence in that reserves resulting from capital profits
transfer duty was payable in such transactions. Thus to
the extent that there was any positive difference between
the notional input credit received and the actual transfer
duty paid, the developer was in effect receiving a payment
from the Receiver.

However, since 25 November 1994, the Value-Added Tax
Act No. 89 of 1991 has been amended so that the
purchase price on which the notional input credit is
calculated is limited to the open market value of the
property regardless of whether the transaction is "at arms
length" or between connected persons, and so that where
transfer duty or stamp duty is payable, then the input
credit is limited to the amount of that tax (Rodrigues,
1995).

It is important that the developer is a registered vendor for
VAT purposes because he will be paying out VAT for
materials, labour and services throughout the
development process and needs to be able to claim back
input credits on each of these items to avoid absorbing
the VAT expense himself. In fact, most of the cash flow
through a developer's company comprises expenses until
the building is sold. The only cash inflows are likely to be
"draw-downs" paid in from an investor or rental income
earned from completed properties.

When the developer comes to selling the scheme, if he is
a registered vendor, he will be required to add VAT to the
selling price unless the development is 50% let or more, in
which case he would be selling "a going concern" in terms
of Section 11(1)(e) of the Value-Added Tax Act No. 89 of
1991 and for which VAT is imposed at the zero rate. No
transfer duty is payable in this instance.

This section of the VAT Act has also been amended with
effect from 25 November 1994 and now the zero rate only
In terms of section 17(1) of the Value-Added Tax Act No. 89 of 1991, any VAT payable may be claimed as an input credit as long as the purchaser is a registered vendor for VAT purposes.

Although income tax is payable by most companies, section 10(1)(k)(IA) and section 11(e) of the Income Tax Act No. 58 of 1962 determine that those companies forming part of property unit trusts are exempt from tax and that any rental proceeds will be taxed in the hands of the unitholders once they have been distributed to those unitholders.

As far as the payment of VAT is concerned, VAT is payable by the seller of a property to the Commissioner for Inland Revenue where the seller is a registered vendor and the property is sold "...in the course or furtherance of any enterprise carried on by him". Section 7(1)(a) of the Value-Added Tax Act No. 89 of 1991.

A developer would be buying the land either from a registered vendor or from a non-vendor. If buying land from a vendor and the property is sold or deemed to be sold in the course or furtherance of the vendor's enterprise, the developer would be required to pay VAT and would be able to claim an input credit. The vendor would then pay the VAT over to the Receiver. No transfer duty would be payable in this instance.

Previously, where a developer bought land from a non-vendor or a seller who was a vendor, but where the property was not sold or deemed to be sold in the course or furtherance of the vendor's enterprise, the developer was not required to pay VAT to the seller, but was nevertheless able to claim a notional input credit, equal to the tax fraction (14/114) multiplied by the purchase price, from the Receiver. Although VAT had not been paid,
Whilst private companies are preferred, it is also true that investors will seldom wish to acquire the shares in a development company from a developer. This is because the history of the company is not known and can be extremely difficult to establish. There is always the risk that the company may have incurred obligations which could expose the investor to liabilities and claims he never imagined existed. Warranties do provide a measure of protection, but ultimately they only offer the purchaser of a company recourse against the vendor who may well be a "man of straw".

The current normal course of action is thus for the developer to sell the property out of his development holding company to the investor or into a company owned by the investor.

Where VAT is paid by the purchaser of a property, no transfer duty is payable.

This is in terms of section 15 of the Transfer Duty Act No. 40 of 1942 which states that:

"No duty shall be payable in respect of the acquisition of any property under any transaction which for purposes of the Value-Added Tax Act, 1991, is a taxable supply of goods to the person acquiring such property...", and

Section 1 (xxvi) of the Value-Added Tax Act No. 89 of 1991 which states that:

""goods" means corporeal moveable things, fixed property and any real right in any such thing or fixed property"."
accounting and the identification of ownership of the respective parties to the investment easier.

From the developer's point of view he has to weigh up the relative merits of holding the development in a company or close corporation with its effective 51.25% tax rate, (35% marginal rate for companies plus 25% STC on any dividend paid out which has effectively already been taxed at the marginal rate), or 54.81% if one includes the 5% transitional levy applicable to income over R50 000 earned in the 1994/1995 tax year, against a sole proprietorship where the marginal personal tax rate of 43% applies.

One of the major advantages of a company is that liability is limited. Whilst it is desirable that any expenses incurred in the course of the development process be deducted from the profits generated by the ultimate sale of the property, the developer would not want to have a separate company for each development because that would preclude him from being able to write off the losses of one scheme against the profits of another. At the same time he would not want to house too many projects within one entity so that the risk of several projects being brought down by one big scheme going wrong is minimised.

From a management point of view it is easier to handle a property held in a company by dealing with a board of directors rather than having to seek individual consent and agreement from each investor with a direct holding in a property investment as recorded in the title deed. This means that investors in property also tend to favour the private company as the holding vehicle of choice. This is confirmed by the response to Question No. 5 in the questionnaire in which 74% of the respondents indicated that they preferred to hold the land in a private company.
Assuming that the developer decides to proceed with the scheme and to purchase the land he would have a deed of sale drafted by his attorney and at this point would need to decide how the development transaction should be structured and what vehicle he should utilise to purchase the land. This decision has important tax and VAT implications especially if the developer wishes to sell the scheme at some later date.

The first consideration is whether the developer should acquire the land personally or through a close corporation, a limited liability private or public company including a shareblock company, or a trust, or through a partnership.

Whilst many residential and leisure developments are transacted through shareblock schemes, most retail, commercial and industrial developments of the size under consideration for the purposes of this study (i.e. R10m upwards) are held in public or private companies unless the property is to be owned by a Property Loanstock Company utilising a shareblock structure.

The main criteria for choosing between a company and a close corporation are that close corporations are cheaper to form and are less expensive to run in that they are not required to be audited.

However, close corporations have more stringent liquidity requirements than companies if members wish to rely on the limited liability afforded by a close corporation. Moreover, since members must be natural persons and no company or other legal persona may purchase the members' interests, close corporations are not ideal for "on-sale" purposes. (van Dorsten, 1990: 28)

Companies and close corporations offer independent legal status and, being free standing entities, make both
characteristics which need to be established before any
step is taken towards acquiring it. It may be on a steep
slope, the ground underneath may be clay or it may be
granite which could require blasting and expensive
earthworks and foundations, it may be undermined or
dolomitic, there may be underground water on the site
and it may need extra expense for the piping and
provision of services such as water, electricity and
sewerage or for the provision of additional street access.

For the purposes of this stage I will assume that the
developer does not own the land and needs to secure the
right to acquire it before he can proceed with the scheme.

Depending upon how sure he is of raising finance for the
scheme and how certain he is to find a tenant, the
developer will either attempt to secure an option to
purchase the site or enter directly into a deed of sale with
the vendor. Alternatively, he may bring the owner of the
land in as an equity partner in the venture.

An option to purchase at some future certain date is
usually purchased from the vendor of the property for a
fixed cash price and has the advantage of enabling a
prospective developer to gauge the specific risks
attaching to that site more accurately without incurring the
major cost of buying the land and paying holding costs
such as interest on any borrowings, rates, taxes and
maintenance charges etc.

Options are usually structured in such a way that if the
right to purchase has not been exercised by the expiry
date the purchaser will forfeit the price paid for the option.
It is not uncommon for the option price to be set off
against the purchase price in the event of the option being
exercised and the land being purchased.
From this number he would deduct an estimate of those operating costs which the owner would bear in order to arrive at an annual net rental. This number would be capitalised by using the appropriate capitalisation rate applicable to buildings of that type and quality in that location.

Once the resultant value of the property is known a developer would typically make a rough estimation of the building costs including interest, taxes, local authority charges and professional fees taking into account the obvious site conditions and physical dimensions of the building (e.g. slope of land, soil conditions, height of building, whether excavation is required for parking, the number of lifts required and the standard of finishes appropriate to the type of building envisaged etc.).

After adding on a profit margin for himself (a number which would be commensurate with the level of risk to be experienced as perceived by the developer) he would be left with a remainder which is usually the amount available for purchasing the land.

2.1.2. Stage 2 - Land acquisition

Land identified for development may be anywhere and occurs in many different forms. It may be one large piece of raw agricultural land or it may be many small sites which need to be assembled, consolidated and rezoned for the appropriate use. It may be vacant or have existing improvements some of which may be retained and some of which may need to be demolished. It may have restrictive conditions of title or servitudes and mineral rights which may or may not be removed or altered, it might have a national monument or a graveyard situated upon it which might have to be incorporated into any proposed development. It will have specific physical
the site are insufficient for the land use envisaged then
the developer would consider making an application for
amendment of the town planning scheme, or rezoning.

At this stage the developer would also look at the
surrounding land use and make sure that it was not in
conflict with his intended use.

If the probable delay caused by such an application is too
long and costly, the developer may consider abandoning
the scheme at this point. However, assuming that the
rights are appropriate, the developer would now calculate
how many storeys his building has to rise given the
coverage factor applicable to the site, again in terms of
the town planning scheme. A simplistic example of this
would be a site of 3000m² with an FAR of 1 and
coverage of 50%. This indicates that premises of 3000m²
may be erected with a footprint of 1500m². Obviously the
building has to be on two levels to comply with the
coverage requirement. After taking the difference between
the gross building area and net lettable area, common
areas, parking, access and landscaping demands on
space into account the developer would then be left with a
total rentable area and total number of rentable parking
bays to work with.

Given the location, type building and tenant/s
envisaged, the developer would pluto rental rates to the
areas of his scheme. These would be rentals that he
hoped to achieve at some time in the future once the
construction of the building was complete and once he
had taken into account a potential vacancy factor and the
economic conditions likely to be prevailing on completion
of the scheme these figures would give him a gross
annual rental figure which could be expected to be
achieved by the building in its first year of operation.
Such projects would typically include the development of hospitals, clinics, schools, municipal, administrative and legal buildings (police stations, courts and prisons) as well as public facilities such as libraries, recreation and community centres, sports facilities, parks and public swimming pools. Private sector non-speculative schemes would include churches, private schools and facilities for welfare organisations.

The distinguishing characteristic of these developments is that whilst they are also born out of need, they are not required to generate a market related return in the form of annual income beyond the ongoing maintenance or operating costs. Although in all likelihood the land on which the facility is developed will appreciate over time thereby providing a notional capital return, it is in fact a notional return because there is no intention to ever sell the property thereby enabling the return to be realised.

Once the idea has been formulated, the prospective developer needs to assess his prospects of being able to pull the three key threads of any development together. These are land, finance and tenants, each of which will be dealt with in separate paragraphs below. Assuming he believes there is a good chance that he will be able to secure each of these three key elements his next step would be to perform a rough feasibility study.

In most cases this would take the form of a residual land value calculation which would start with a calculation of the rentable area which could be established on the site earmarked for development.

The rentable area is usually calculated by taking the footprint of the site and multiplying it by the Floor Area Ratio (FAR) or bulk factor attributed to the site by the applicable town planning scheme. If the rights attaching to
If the design is not versatile or flexible enough or aesthetically pleasing, this could have a detrimental effect on the ability of the owner to let space in the building at a later stage.

If the developer attempts to extract too much value from the scheme by squeezing as many lettable square metres into the development as the site will allow, the unwieldy proportions of the scheme and its likely "blackhouse" appearance could make subsequent letting difficult and consequently prejudice the developer's potential return.

From the point of view of costs, if the quantity surveyor receives too little information or makes incorrect assumptions on building costs, escalation rates, interest rates and inflation, his forecast on the costs of the project may be wrong and this could have serious financial implications for the developer.

There is also the risk that some external and unforeseen economic event occurs which renders the cost calculation meaningless.

There is always the risk that consent required either from the local authority, the state or a neighbouring property owner or other individual who has some rights to the land making up the site, is not granted and the scheme is unable to proceed. Examples of consents required would be for rezoning, consolidation or cancellation of a servitude. Appeals to a higher authority, e.g. the Provincial Townships Board, are both time consuming and expensive and may render the development unfeasible. Also, even if the appeal is successful there is always the risk that the appellant receives a lesser or more qualified right than the one originally required to make the scheme work.
feasibility study might be wrong also making the scheme unworkable.

The developer may secure an option over the land and then be unable to find finance to proceed with the scheme resulting in his losing the option purchase price.

It may be that the valuation of the land, whether undertaken by an independent valuer or by the developer himself, is incorrect or overestimated and that the developer pays too much for the land thus eliminating or reducing any prospect of a profit from development on the site in the short to medium term.

Any delay in progress with the project due to an oversight in the developer's research with regard to the underlying land would result in the developer unnecessarily having to bear the finance charges on any borrowed capital used to acquire the land as well as the cost of rates, keeping the land clear of vegetation and squatters, if vacant, or having to manage the existing premises on the site if it already has improvements upon it.

2.2.3. Risks - Stage 3. - Design, cost and consent

The risk exists that the design prepared is inappropriate for the site or the intended use of the project, or both, and has to be redone by the same or another firm of architects. This would have the effect of delaying the preparation of a marketing brochure or presentation and consequently with the developer's ability to raise finance for the scheme. This delay would also prevent the developer from having the project accurately costed by the quantity surveyor who would require plans from the architect for this purpose.
Another risk would be that the timing of the scheme is wrong and that the duration of the project is too long to catch an anticipated upswing in the property and rental cycle. An excessive project duration would also allow competing schemes to get off the ground thereby reducing the letting potential of the original project.

The developer risks any up-front payment made to professionals such as town planners, architects, land surveyors and market research firms if the scheme fails in the early stages.

If the scheme does not work out, the promoter or developer could lose credibility with investors depending on their level of exposure to and involvement with the scheme at that stage.

It must be stressed though that when compared with the rest of the life of the project, the risks are minimal at this stage.

2.2.2. Risks - Stage 2. - Land acquisition

The fundamental risk at this stage is that of acquiring the site and then discovering some flaw in the rights attaching to it or in its physical state which would prevent it from being developed as originally envisaged.

Typically this would occur where the site had been improperly surveyed and the boundaries incorrectly marked out or where the title deed was not properly inspected and the rights of another to the land had been overlooked.

The site may be incorrectly measured and the developer's calculation of lettable space on which he based his rough
any tenant to sign up. The potential for confusion at this stage of the scheme is high and a development agreement needs to be very clear on who bears what costs, what responsibilities and for how long those responsibilities exist.

The use of a professional property manager is recommended at this stage to ensure co-ordination between the various agents bringing potential tenants to the scheme and to run the necessary credit checks on potential tenants to ensure that money is not wasted on installing a tenant who defaults on his rental payments after only a couple of months.

2.1.7. Stage 7. - Management and ownership

This is the final stage of the process where construction of the project is complete and the building is handed over to the owner.

Letting may still be in progress and there will undoubtedly be an ongoing list of "snagging" items which need to be attended to by the developer as directed by the owner. Practically, the only way to ensure performance at this stage is for the owner to hold back a substantial retention against performance by the developer.

2.2. Risks particular to each stage

2.2.1. Risks - Stage 1. - Concept/feasibility

Initially the major risk is that the original concept does not work out and the area in which the development is situated does not upgrade as planned or the businesses which the developer has in mind as potential tenants are no longer attracted to the location.
search for an appropriate tenant should begin immediately the scheme is conceived although it is often only practically possible to secure a tenant once the project has reached a stage at which the developer is sufficiently able to demonstrate to the potential tenant what it will be receiving in return for the rental asked.

Letting the premises offered in the building is crucial to the success of the project for it is the tenant which generates the cash flow which should provide the investor with a return on its capital outlay and which in turn will hopefully induce it to fund the development in the first place unless of course the building is to be occupied by the purchaser for its own use.

By this stage the developer or investor should have an accurate figure, based on research in the field, for the market rental levels (in Rands per square metre) for the sort of premises offered in that specific location as well as a budget indicating, with reasonable accuracy, what the operating costs of the building will be.

One tenant may occupy the entire building or there may be several smaller tenants each of whom would require partitioning and separate fitting out contracts. An installation allowance would have to have been budgeted for in the cost of the contract and the fitting out process would have to be managed either by the developer or investor to ensure that no budget overruns were incurred without some agreement with the tenant as to who will bear the cost.

Generally it is preferable for the investor to use his own lease form, with which he is familiar, when tenants are signed up for the building. This is in order to prevent rights being given away by a developer over anxious about his “bottom-line” or rental guarantee and desperate to induce
Other important aspects of the construction stage which a developer or investor should be aware of from a risk perspective are the possible limitations to the risk of the builder failing to perform by means of preventative measures such as performance guarantees and development retentions.

Performance guarantees are generally issued by insurers or banks and usually vary between 10% and 12.5% of the value of the building contract. Such guarantees are usually released on "practical completion" of the contract. (da Silva, 1990 and Schluss, 1995)

Building retentions on the other hand are payments withheld from the contractors according to a pre-agreed formula in the contract document and released to the contractor during the course of the contract on completion of defined stages of building work within time and according to the standard and specifications agreed.

Both of these measures are accepted risk management techniques usually incorporated into the building contract.

It is also at this stage that a developer may consider hiring the services of a project manager to ensure the effective coordination of all the participants in the construction process. Usually this is the architect's responsibility and if a full brief has been given, and paid for, would include this service.

2.1.6. Stage 6: Letting

As mentioned above, after land and finance, the tenant to whom space in the scheme will be let is the third essential ingredient in conducting a successful property development project. Indeed, if the entire project was not initiated by a tenant requiring suitable premises, the
Previously the contractor who was liable for the risks inherent in the building process was obliged to insure against those risks and was bound, in terms of the contract, to show proof in writing, from the insurer to the architect, that the required cover had been effected.

Now, the contractor is still responsible for those risks, but has the option of negotiating with the employer to decide who will take out the works risk insurance. In addition, the JBCC contract imposes a limit on the extent of the contractor's liability, namely the extent of the insurance cover which the employer is prepared to pay for. Any risk falling outside that cover is for the employer's account.

The JBCC contract also provides for the employment of three categories of sub-contractors. These are: (i) nominated sub-contractors for whom the employer bears the risk of performance, (ii) selected sub-contractors (the contractor has a say in the selection of this category of sub-contractor and consequently bears the risk of performance), and finally (iii) non-nominated sub-contractors for whom the contractor bears the risk of performance.

In addition to the customary allocation of risk through the agency of the JBCC contract as described above, it bears mention that a new trend is emerging in construction contracts. This is the appearance of management contractors who effectively assume the role of employer, enter into construction contracts with the various building contractors and sub-contractors and, for a consideration, assume all the risks which would typically have been borne by the developer, excluding the risks of raising finance for the project, procurement of a purchaser for the scheme, and letting.
management than of assuming the more traditional development risks.

One of the advantages of "in-house" development to the institutional investor, apart from the potentially enhanced return, is the fact that it has far greater control over the design, quality of construction and letting and management of the property than it would have if dealing with a developer with a rental guarantee in place and who was trying to cut costs at every turn either to minimise losses, if the building was not letting well, or maximise profits where the letting had proceeded as anticipated.

2.1.6. Stage 6 - Construction

The construction phase involves the employment of a building contractor by the developer. This legal relationship is regulated by means of a building contract. A generally accepted building contract which is widely used in South Africa today is the Joint Building Contracts Committee (JUBCC) contract which was drawn up by the Association of South African Quantity Surveyors, Building Industries Federation South Africa (BIFSA), Institute of South African Architects, South African Association of Consulting Engineers, South African Property Owners Association (SAPOA) and Specialist Engineering Contractors Committee.

This contract was drafted in 1991 and one of the major changes over previous similar contracts is in the field of the contractor's liability for "works risk" (i.e. risk of injury to persons including workmen and third parties or damage to property either comprising the contract works or belonging to third parties by accident or arising out of fault, negligence, failure of structures, or due to losses or damage caused by Insurable perils) (Strohmeier, 1992)
made to the developer (i.e. the return to the investor during the construction phase of the scheme is capitalised into the overall cost of the investment).

Having decided what form of end-financing is appropriate and likely to be obtained, the developer would probably need to obtain short term financing from a bank or property financing institution to enable him to proceed with the acquisition of the site, make interim payments to professionals and to continue with the marketing of the project: i.e. approach investors, present the scheme and negotiate his involvement with them.

The short term financing would be in the form of a loan secured by the underlying property and it would be unusual for the lender to voluntarily take any equity in the scheme. Only in the event of the scheme failing or the developer becoming insolvent would the lender have to foreclose on the property and become an equity investor in the project by default.

The distinction between the various levels of financing is often blurred with institutional investors providing both long and short term finance as they become more sophisticated.

In many instances institutions have realised that, given the availability of skills which they can hire and offer "in-house", they no longer require the developer to take the risk in the project and often prefer to assume the role of developer with its risks and consequent profits provided that the development is successful.

Obviously in the case of an institutional developer one of the major risks, that of securing finance, is eliminated. In this situation the developer's role is more one of identifying development opportunities and project
a headlease over the entire premises or at least for the unlet space.

Where a long term investor such as a pension fund, life office or listed property vehicle is involved in the scheme it would usually be as an equity investor who would allow the developer to draw down funds to finance the development at various stages in the planning and construction process against proof that work had been completed.

If prudent, the investor would retain the services of a "watching brief" quantity surveyor or architect to ensure that the building plans and specifications had been adhered to before making any payment. This would be especially appropriate where payment is to be made against progress certificates signed by an architect employed by the developer.

Just as a lending bank would expect to earn interest on any money disbursed to a borrower, so too do institutional investors in property expect to earn a return on funds drawn down by a developer before the building is completed, int and generating a return in the form of a rental cash inflow.

Institutional investors achieve this return by applying a notional required rate of return, usually closer to the return or yield the investor would expect to earn from the property investment itself than to current money market rates, to the funds drawn down. This rate is confirmed by the answer to Question 33 in the questionnaire in which 68% of the respondents indicated that they used a property related return.

The investor would then deduct the total amount of notional interest from the overall development payments.
2.1.4. Stage 4. - Financing

By this stage the developer will have prepared a marketing brochure and presentation which will contain a written document outlining the concept, locational maps, demographic survey data, drawings, plans, a detailed feasibility study including cost calculations, rental research and a tenancy schedule with letters of intent from proposed tenants, if any.

The developer will then need to decide whether he wishes to arrange long term debt finance for the scheme so that he can remain owner for an indefinite period to enable him to sell the building when it is full of tenants thereby optimising his timing in the property cycle and achieving the maximum possible return, or whether he needs to find an investor to sell the scheme on to at the earliest opportunity whilst still securing his role, and consequently profit, as the developer.

Selling the scheme on in the early stages means that the risk of finding tenants and therefore of securing the cash flow which will provide the return on the purchase price paid, is limited for the developer by its transfer to the purchaser. Investors are normally fully aware that they are assuming this risk and will usually demand a lower price or higher yield as compensation for this risk.

Investors may also ask for some form of rental guarantee to secure their return for a period. Typically they would first make sure that there was enough profit in the scheme for the developer to cover such a guarantee and even then they would probably make it a term of the development agreement that those funds be held in trust until the period of the guarantee had expired. Alternatively, they may require the developer to enter into
enter into a retroactive agreement assuming additional liability for work already done and over which he has had no actual supervision or control.

This stage would also see the employment of a number of other professionals. The first of these is the quantity surveyor who would prepare a bill of quantities and an accurate cost calculation running out for the full anticipated construction period. The quantity surveyor's calculations would also include the payment of interest on the funds drawn down from either the interim financier or the ultimate investor depending on the structure of the scheme.

The services of a land surveyor are required to site the building, to peg out the precise boundaries of the site and to identify any pipeline, or sewerage access servitudes, building lines and other possible physical constraints to the proposed use for the site.

Structural, mechanical and electrical engineers would be required depending upon the complexity of the building and other specialists such as project managers, town planners, landscape architects, traffic and noise control experts may be retained at this stage.

The town planner is responsible for ensuring that all the applicable town planning regulations are complied with and that permissions are obtained to enable the developer to proceed with a scheme having all the necessary rights for the use intended. Any application for permission for rezoning, consent use, consolidation, relaxation of building lines, cancellation of servitudes, the laying of water and sewerage pipelines or the deviation of overhead power line cables would usually be commenced at this stage.
is only binding between the parties and it is ultimately the client who is responsible for paying his own attorney.

The "essential" clauses to the agreement are listed below both by clause number and heading. "Essential" clauses are those without which the transaction would have no form and the intention that the specific agreement between the parties be recorded to avoid ambiguity and potential financial loss would not be fulfilled. The content of these clauses will be discussed in the following paragraph entitled - 3.2. An evaluation of the risks managed by a sample development agreement.

1.1. Definitions
1.5. Measurement
2. Conditions precedent
3. The development
4. The professional team
6. Security by the developer
6. Design documents and deviation procedure
7. Total development costs
8. Appointment of letting agent
9. Guarantee by developer
10. The initial return
11. Tenant Installations
12. Inspection rights
13. Indemnity
15. Fact list
16. Commission
18. Insurance
19. Risk and handing over
24. Developer no agent
Para. 14. This the arbitration clause is found in many agreements and simply serves to set out a procedure intended to be quicker than the Supreme Court procedure whilst allowing confidentiality and a choice of arbitrator. It is not necessarily a cheaper procedure.

Para. 17. Confidentiality applies to this agreement as much as it does to many other agreements. The intention is to prevent competitors establishing the terms of the agreement and approaching the investor with a better offer.

Para. 20. The restraint on cession is important in development agreements and serves to ensure that each of the parties knows whom it is dealing with whilst the contract is alive.

Para. 21. The domicilium clause is found in just about every written contract and indicates the contact addresses of the parties to the contract for the service of legal documents.

Para. 22. The default and cancellation clause is procedural and ensures that the parties give each other an opportunity to rectify any default before proceeding with cancellation and any claim for damages.

Para. 23. The whole agreement clause ensures that the signed document is the final statement of the terms of the transaction and can only be varied in writing with agreement by all signatories.

Para. 25. Most agreements contain a clause indicating who is responsible for paying the attorneys fees and other costs and the development agreement is no exception. One should bear in mind that this clause
Chapter 3.
How effective are existing property development agreements? - An examination of a typical existing development agreement.

3.1. Distinction between "standard" clauses, and the "essential" clauses appropriate to the allocation of risk in the property development process.

An example of a typical property development agreement is contained in Appendix 1. to this report. All references to clauses in the following paragraphs are to clauses contained in "Appendix 1."

"Standard clauses" are those which are necessary for the proper functioning of the transaction and for effective implementation of all the terms contained in the agreement, but which are not necessarily unique or specific to the particular transaction being regulated by the agreement.

The following are "standard" clauses in the agreement under review:

Para. 1.2. This clause indicates that the headings are used for convenience only and should not be used for interpretation.

Para. 1.3. States that any reference to an enactment is to that enactment as at the date of signature of the agreement.

Para. 1.4. Confirms that if any provision in the "definition" section is a substantive provision, it is as effective as any other substantive provision in the agreement.

Para. 1.6. States that references to "writing" include telex and telefacsimile
project, he runs the risk of experiencing a diminished return through poor letting.

2.2.7. Risks - Stage 7 - Management and ownership

A major risk at the stage after completion is non-insurance of the building after the contract works insurance has expired.

The risks of non-compliance with local authority regulations in respect of fire, water and electricity supply and safety should also be considered.

It is at this stage that the risk of recovery of any payment for work not properly completed or for defective work by the developer is highest for it is only now that certain latent defects in the buildings of the scheme will materialise and be discovered by the tenants or building manager and by this time the developer and building contractor will have moved off the site and be busy with their next projects.

As will be seen in the following chapter where the effectiveness of a typical development agreement is examined, many of the risks detailed above may be managed by applying forethought and negotiating and drafting a development agreement.
2.2.6. Risks - Stage 6. - Letting

At this stage the risks are that letting does not occur as anticipated both as to speed and as to the expected levels of rental achieved.

The creditworthiness of tenants may be a problem especially where there is a rental guarantee in place and funds are released on the strength of a lease which lasts only for a short while before the tenant absconds or otherwise breaches the terms of the lease.

Some structured leases pose a similar problem in that all the risk in the lease is "loaded" towards the end of the term of the lease and the tenant's financial health at that stage is an unknown particularly at time of signing of the lease.

Investors need to be vigilant with regard to the quality of the tenants a developer signs up in order to procure its release from the financial and other obligations created by the existence of a rental guarantee or headlease.

A greater number of smaller tenants rather than fewer larger ones imposes an additional management responsibility (with greater cost implications) on the investor after the building has been handed over.

Installation and leasing commission allowances have been discussed in the paragraph dealing with financial risks above, but they also find application at the leasing stage.

If the facilities offered by the project in terms of lettable area, configuration, availability of parking, aesthetic appearance, landscaping and access are not what the investor thought he was to receive when he bought the
be properly taken out and that the premiums be paid regularly bearing in mind the potential losses and claims for damages which might arise should this not be done.

The second category is of risks which are not easily, if at all insurable and which need to be managed away as part of the development process. Examples of these risks are the risks of delay due to weather or labour action, the risk of building in the wrong area, in the wrong place on the site, using non-specified materials and of poor quality workmanship. Other risks are a shortage of materials or theft of materials off site or the late delivery of materials.

An unforeseen escalation in the cost of labour, materials and other building costs may cause the developer's ceiling cost to be exceeded during the project. A well drafted development agreement would make sure the respective parties were aware of who bears this particular risk.

There is the risk of a structural or other defect arising in the scheme where the developer gave an incomplete brief to a professional e.g. the architect, consequently leaving the investor with no claim against the architect for performance or damages, but only with a personal claim against the developer who is quite likely to have no assets in the company he uses to contract with the investor.

Late or non-completion of work by sub-contractors is a risk experienced during the construction phase and for which responsibility must be clearly allocated.

Insolvency of the main contractor is an additional risk which would negatively impact on both the developer and the investor.
An additional risk arises where the project is a large one with a value of say several hundred millions of rand and where a consortium of investors is established to share the costs of and ownership of the scheme. There are various dynamics to the relationships between the members of the consortium, such as different weightings of share holding and consequently power to ensure a particular course of action at shareholder's development progress meetings, differing accounting methods between shareholders, different ideas about what professionals and contractors should be employed, differing ideas about the location of tenants within the scheme, of rental levels, of rental guarantee reconciliations, of the particular property manager to be employed and the allocation of responsibilities to and level and method of remuneration of the property manager. All of these risks entail an element of timing or delay in implementing part of the ongoing property development and management process as well as an element of financial loss arising out of disagreement or delay.

Finally there is a further risk involved in recovering the notional interest calculated on disbursements made to a developer. This calculation must be made and double checked by the investor before making any final payment to the developer. Once money has been paid over to a developer it is the experience of the writer that it is almost impossible to recover such funds if an error has been made in calculation.

2.2.5. Risks - Stage 5 - Construction

There are two categories of construction risk which operators in the property development industry should be aware of. The first is "works risk" as described on page 32 above. With regard to this first category of insurable risks, there is a requirement that the necessary insurance cover
agreement envisaged, the investor will lose out. On the other hand if it has more, then he gains. A typical precaution would be to include an adjustment mechanism in the development agreement and to have the building finally measured physically, on site, once it has been handed over to the investor and before calculating the final price.

There is risk in bearing the cost of rectifying structural defects which may only materialise after the building has been handed over.

Where there is a rental guarantee in place there is a risk in the nature of the accounting methods used to determine when the agreed level of return has been reached to extinguish the guarantee. (i.e. what is the distinction between capital and income expenditure when calculating net income?). Allied to this point is another financial risk in that the payment of operating costs needs to be specified as forming part of the determination of the net income for purposes of reconciling the rental guarantee calculation. If it is not and the gross income is used, the required rate of return necessary to release the developer from his rental obligations will be reached before the investor anticipated that it should.

There is the risk that the actual operating costs are higher than those budgeted and that the scheme does not show the required return once it is handed over.

If the Investor is not a registered vendor for VAT purposes, there is a risk that it will not be able to recover any VAT input credits due on the money paid over to the developer or for operating expenses made in respect of the project.
From the investor’s perspective there needs to be clear agreement as to who owns any retentions, specifically in the event of an insolvency, otherwise the money will be deemed to form part of the insolvent estate of the developer and the investor will simply be a concurrent creditor without recourse to the retention fund to remedy any defects in the works.

Other risks are of overpayment to the developer where work which should have been done has not yet been completed, the risk that the money paid over to the developer as a progress payment for work done, including the work of the sub-contractors, is not distributed fairly and timeously to those sub-contractors and the risk that the developer takes money from one job and uses it for other applications in his business leading to an inability to complete or make satisfactory progress with the job for which the payment was made.

Where there is a fixed price calculated to be paid for the development by the investor to the developer and the finished product includes a fully tenanted building, there is a risk in the calculation of the allowances required for tenant installations, which may only be completed several years after the building is handed over by the developer and after building costs have run up far in excess of the amount (plus interest) retained for the purpose from the total payment to the developer. The same concerns apply to the calculation of any commission due to estate agents responsible for negotiating leases with tenants for the building.

There is a major risk to the investor in the measurement of the building since the purchase price he is paying is usually calculated according to the number of rentable square metres and the number of parking bays the finished building will contain. If it has less than the
The dilemma for the investor is that on the one hand, if the money is paid over to the developer it could just disappear into some other job, but on the other hand if the investor disburses the money directly on materials or to pay a sub-contractor or whatever, it is not tax deductible in the hands of the developer unless the transaction is structured on the basis that the investor is merely paying the other parties for and on behalf of the developer.

Finally there is a risk to the developer that his financier may run out of money before full payment for the project has been made. If it is a large, highly speculative or very specific use project, the developer may experience substantial difficulty, delay and losses whilst attempting to re-finance the project. It is conceivable that he may be unable to proceed with the scheme at all and then be left only with a personal claim for damages against his investor whilst facing numerous claims from his own creditors.

The financier would be equally concerned with the financial soundness of the developer's business since an insolvency would cause immense practical difficulties with the scheme and depending on the amount of retention held by the investor and the nature of the development contract signed could cause financial losses as well.

When conditions precedent are incorporated into any agreement with the developer, the investor needs to be careful to ensure that those conditions precedent are waived or fulfilled before proceeding with the project for there is the danger that in the event of the insolvency of the developer, where the conditions precedent have not been compiled with or waived, that the developer or its liquidator or other creditor will regard the contract as void thereby leaving the investor with only a claim for unjustified enrichment against the developer.
There is the risk that a builder may exercise a lien over the building in the event that he is not paid by the developer or investor depending on which party he contracted with.

Where work has not been completed according to the contract, but the employer has benefited from the builder's work and materials, then the employer has been unjustly enriched at the expense of the builder and must recompense the builder to the extent that he did benefit from his work.

In the event that the contractor's work is incomplete or defective, he may claim payment of the contract price less the damages suffered by the employer in having the defective work remedied or the incomplete work completed.

However, where the contract stipulates that there will be no payment unless the work is completed, payment may legitimately be withheld until completion. Equally, where the builder abandons the job before completion or wilfully departs from the terms of the contract and, for example, uses inferior materials so that the owner justifiably refuses to accept the work and consequently receives no benefit, the builder has no claim against his employer for payment of the work done. (Gibson, 1977)

There is a risk to the developer from a tax perspective if any development retention funds are held in the investor's name. If any development expenditure is made from these funds by the investor, they may not be deductible as expenses against the rest of the developer's business. However, payment to the developer by the investor may prove to be a problem for the investor especially where there has been a problem with the developer's performance on the project.
2.2.4. Risks - Stage 4. - Financing

A great deal of the risk in property development is financial and for the purposes of this report it will be examined primarily from the perspective of the developer and the investor although clearly all of the other participants are also exposed to some degree of financial risk.

The obvious financial risk is that the developer is unable to convince anyone to finance his scheme at all which will kill it. The next degree of risk occurs where the developer is able to arrange finance, but on such onerous terms that there is very little benefit left to him by proceeding with the project. If times are tough and there is very little work around, he may still accept financing of this nature in order to keep his business operating. Onerous terms would include retentions, performance guarantees, rental guarantees, headleases, high interest rates and the like.

There is a risk that, once the finance has been arranged, the "draw-down" procedure with the investor is so cumbersome or difficult that the developer's cash inflows become erratic and he is unable to meet his commitments with regard to building contractors, materials suppliers and providers of services etc. This will make these operators circumspect in their dealings with the developer and may prejudice the smooth progression of the project.

The developer's cash inflows could also be negatively affected by any non-performance of contractors for whatever reason. If work is not completed to the satisfaction of the investor and its professional advisers, money in the form of progress payments will not be forthcoming until the work is completed satisfactorily.
Para. 5. **Security by the developer**

This clause represents a straightforward transfer of risk for any non or late performance by the development team from the investor to the developer. It also ensures that any financial losses which might be suffered by the investor are minimised by the flow of performance guarantee, retention and insurance payout funds directly and immediately on receipt by the developer to the investor.

The security involves a cession of the following rights initially enjoyed by the developer:

- performance guarantees,
- the right to retain or receive penalties for late completion,
- benefits paid out by the developer’s insurers,
- any funds retained by the developer against the main contractor, sub-contractors or the professional team.

A further important measure to ensure that any claim against and consequently risk to the investor is minimised, is the requirement that all builders’ liens be waived by builders, contractors and sub-contractors.

Para. 6. **Design documents and deviation procedure**

This clause requires the developer to produce initial and final building documents as specified by the
In terms of the sample agreement, the developer warrants that all persons, particularly professional persons, appointed to be engaged with the development shall be duly qualified for what they are appointed to do and more importantly para. 4.5. of that agreement categorically states that no member of the professional team, contractor, sub-contractor, agent or employee of the developer will be or will be deemed to be a nominated sub-contractor of the company (i.e. of the investor) and that there will be no "privity of contract" between the company and those persons.

No "privity of contract" means that there is no legal contractual relationship between members of the professional team, contractors or sub-contractors and the company. This is an important provision from the investor's point of view since it only wants to have to deal with one claim in the event of defective or non-performance by the developer. If this clause was not included, the investor would run the risk of becoming embroiled in legal wrangles between itself, the developer and a myriad of sub-contractors.

Whilst there is no formal contractual relationship between the parties as outlined above, para. 4.3. does require the agreement of the developer to ensure that even though the architect is employed by the developer, that the architect confirms in writing that he does act for the company throughout the development process and that the company/investor should be entitled to consult with him freely at all times.
In practice, issues of this nature would be negotiated between the developer and investor as and when they arose and in my experience investors are generally fairly flexible as long as the original appearance and quality of the development is not compromised.

Para. 3.3.15. This clause is extremely important to the investor and deals with the remediating of a variety of defects which may appear in the finished product. Defects are a significant risk and depending on the size of the scheme can run to millions of rands worth of rectification work.

Defects covered are those patent defects which may appear during the 90 day maintenance period, water leakages which may materialise during the 12 months after the first heavy rainfall occurring after the completion date and finally latent or structural defects which occur or become evident at any time within a period of 3 years after the completion date.

Para. 4. The professional team

Approval of the nominated team and the condition that any changes be agreed by both the developer and the company ensures that the team is objectively selected and that there is minimal bias towards either party in crucial decisions such as whether to extend the construction period and when the final completion certificate should be signed. By the same token, the developer is obliged to disclose all details of appointments, terminations and replacements of persons whose services are employed by the developer.
Para. 3.3.13. That he will enter into the specified building contract (a copy of which would be appended to the development agreement) with an agreed building contractor and ensure that a retention, in money, of not less than 5% of the building contract price is held as security for the obligations of the builder in terms of the building contract. It would be prudent for the investor to insist that this retention money be placed in a trust account over which it has some control and which will be released on the advice of the developer, as confirmed by the investor's own professional team, that the building work has been completed satisfactorily.

Para. 3.3.14. That he will ensure that the development occurs, the grounds are landscaped, design documents and specifications of materials are substantially complied with, that a standard of workmanship and finishes is maintained as specified or, where the design documents fall short, in accordance with the standard of similar buildings of a similar quality and in the same location.

Whilst this clause offers protection to the investor and allows him to insist on receiving the quality product he was advised he was purchasing when the samples of materials and finishes were first presented to him, it also affords the developer some leeway in the event that he experiences a shortage in supply of a particular material or a significant delay in the delivery of a specific item, say roofing tiles, which might delay the progress of the entire scheme. As long as the materials to be used "substantially" comply with the specification then the developer is not at risk.
Para. 3.3.8. That he will make provision for support of walls, buildings and roads etc. on adjoining sites and take all reasonable measures to prevent any avoidable nuisance in or on the land and which may affect owners, tenants or occupiers of adjoining property.

Para. 3.3.9. That he will ensure that necessary soil investigations are undertaken and that the foundations are laid in accordance with the engineer's specifications.

Para. 3.3.10. That he will ensure that the development is in accordance with the township conditions of the land.

Para. 3.3.11. That he will ensure completion by the intended completion date with the proviso that if construction is delayed by a reason beyond the control of the developer which was not foreseen at the time of signing of the development agreement and is considered sufficient by the architect, then the architect may certify a fair and reasonable extension of time for the completion of the buildings.

This clause is included for the benefit of the developer who might otherwise have had to bear the risks of not being able to complete the scheme within the allotted time.

Para. 3.3.12. That he will procure that the contractor and sub-contractors agree with and comply with the terms of this agreement.

This is a logical place for this risk to be positioned for although a copy of the building contract is appended to the development agreement and will have been vetted by the investor, the developer will be the party who negotiates the main building contract and the terms of the sub-contracts.
where the developer is experiencing cash flow difficulties he will use the progress payments from the investor to fund some other more pressing need in his business. Although the investor has a measure of protection in that he may attend the site progress meetings, as is evident from the next clause, to my mind it would be better to include a term in the development agreement authorising the investor to make payments directly to contractors should the need arise. It is then up to the investor to determine from the contractors the moment a payment is not made and the investor's potential loss may then be limited to one progress payment.

Para. 3.3.5. That he will allow the investor or his representative to attend development site meetings and any other meetings with consultants.

Para. 3.3.6. That he will procure approval of the design documents, consents, town planning and zoning provisions required for the construction of the buildings. One would expect the major rights applicable to the site to be known and granted by this stage so that there were no unnecessary delays in the process from the commencement date. However, this clause puts the risk for any rights not achieved squarely at the door of the developer which is where it should be if he has warranted that the site has certain rights attaching to it.

Para. 3.3.7. That he will pay all fees and charges in connection with the submission and approval of plans for the development or for the provision of public utility services (e.g. water, electricity, sewerage and telephone connections). Also to pay any development contribution or "betterment" due to the local authority.
Para. 3. The development

This clause is the very "essence" of the contract and sets out exactly what the developer and the investor expect from each other. It is the main "give and take" area of the contract and the relative positions of strength that the respective parties occupy during the negotiation process will determine the nature of this clause.

The clause deals with the following issues:

Para. 3.1. What is to be built.

Para. 3.2. The requirement that the developer employs consultants, contractors and sub-contractors to enable him to complete the project timeously.

Para. 3.3. Obligations of the developer:

Para. 3.3.1. That he will commence on the commencement date.

Para. 3.3.2. That he will supervise the consultants appointed.

Para. 3.3.3. That he will effect the necessary insurances which will be at least those required in terms of Para. 18. of the agreement. This clause is for the protection and good of both the developer and the investor.

Para. 3.3.4. That he will supervise and co-ordinate payments to consultants and contractors against construction progress certificates, specifically ensuring that no payments are made in advance and that the normal retentions are effectuated.

This is another area where enormous problems can be encountered in development projects. Often
agree on a realistic monthly rate per square metre for operating costs, there is an automatic conflict of interests between them over the appointment of maintenance contractors for the property. The developer will be seeking to minimise costs by hiring the least expensive cleaning, gardening and security staff whilst the investor will be endeavouring to keep its tenants happy in occupation of their premises in the building by providing them with a reasonable service for the rental and operating cost contributions they pay over each month. In addition, there are the problems of the rate of escalation of the operating costs over the guarantee period and the liability for any sudden unforeseen maintenance costs.

Would those be for the expense of the developer or the investor? Who will bear the risk? There is no absolute answer to this question so the issue must be resolved, agreed upon and documented in the development agreement before embarking upon the scheme.

**Para. 2. Conditions Precedent**

Conditions precedent are those conditions which must be met for the agreement to remain in force and existence. Their inclusion is primarily for the protection of the investor who needs to know that his ownership of the land is secure, that the land is correctly zoned for the intended use and that all the requisite consents and permissions have been granted by the local authority before proceeding with the scheme and before making any major payments.
the project architect's inspection prior to his issuing the "final completion certificate".

Para. 1.1.15. The "final measurement" definition should be read with Para 1.5, which states that all measurements of the buildings are on the BOMAI (Building Owners and Managers Association International) standard. Two aspects of risk management are offered by this definition. The first is that the architect (specifically the professional who prepared the actual plans and managed the construction off them) must certify the total rentable space and the number of parking bays. Secondly, the system of measurement is specified. There are several different standards of measurement (e.g. American National Standard, BOMAI, and the SAPOA (South African Property Owners Association) methods). It is not that important which standard is selected other than from the point of view of ease of use and generally being understood, but rather vital that a standard is agreed upon to ensure certainty.

Para. 1.1.17. The definition of "initial return" should be read together with Para. 1.1.22. which defines "net rental" because the initial return is the area determined by the final measurement multiplied by the net rentals applicable to the various categories of rentable area.

These two clauses need to be carefully considered in that the definition of initial return does not take the payment of the operating costs (e.g. insurance, rates, water, electricity, security, cleaning, gardening and refuse removal) into account.

This presents a minefield of potential problems in that even assuming that the developer and investor
every day that passes from this date where the building is not fully let the developer will lose money.

The developer is very aware of this date and the investor should be alert to the risk that the developer will do everything in his power to postpone the "completion date" where he is battling to find tenants for the building especially where the notional interest payable on the drawdown amounts is less than the amount the developer is losing in terms of the rental guarantee.

An additional reason for the importance of the "completion date" is that it signals the start of the 90 day maintenance period during which the developer bears responsibility for the rectification of patent defects in terms of the JBC research contract (June 1991 edition). It also marks the start of the three year latent or structural defect liability period and the water leakage liability period of 12 months from the date of the first heavy rainfall after the "completion date". Once these periods have lapsed, the risk and responsibility for rectification of any structural defects or water leakage and of any consequent damage suffered, reverts to the owner.

Para 1.1.14. The "final completion certificate" is an area of potential risk to the investor in that once this certificate has been issued by the architect any claims against the developer for rectification of problems will have to be made in terms of the normal protection offered under the common law relating to latent defects. Claims through this process are much harder to implement than those secured by the withholding of a retention. It is thus in the investor's interests to employ an independent professional (e.g. architect or quantity surveyor) to double check
way out of the deviation from the terms of the contract with the investor.

**Para. 1.1.3.** The limit and variation formula for fixing the "ceiling cost" is crucial in determining the investor's cash outflow limit and in providing the developer with certainty as to how much he will be paid for the scheme. This is an agreed number and the developer will have calculated that he can complete the project and make a profit within this amount.

**Para. 1.1.4.** The "commencement date" is a key one in that it fixes the time from which the developer's liabilities, in respect of the contract, begin and the date from which insurance cover should be put in place. It is the date from which the term of any performance guarantees would be calculated and also the date from which any interest accruing to the developer from retentions held by the investor would be calculated.

**Para. 1.1.5.** The "company" referred to is the investor's holding vehicle. In this instance it is a private company with limited liability which was purchased from the developer. This transaction will have enabled the investor to avoid paying transfer duty on the land, but will have exposed it to any liabilities of the company to the extent that the investor was not protected by warranties or to the extent that the warranties were ineffective. The share sale agreement is appended to the development agreement, but falls outside the scope of this report.

**Para. 1.1.6.** A description of the "completion date" is vital in that it marks the start of the developer's liability for meeting the obligations of the rental guarantee. For
3.2. An evaluation of the risks managed by a sample development agreement (Appendix 1)

In this chapter, only those clauses dealing with the allocation and management of risk in the development process will be considered and commented on.

This sample development agreement was drafted for a scheme combining both office and warehouse space. In order to accommodate the requirements of future tenants, which were unknown at the time of signing the agreement, the respective areas of office and warehouse space were described by means of upper and lower limits to be finally measured once the scheme was fully let.

The following analysis should be read in conjunction with "Appendix 1".

Para. 1.1. Definitions

Para. 1.1.1. Limits on the lettable area of the "building" and the number of parking bays provided are important from the investor's point of view in that the price paid for the development is calculated according to the net rental achievable in the first year. Both the investor and developer will be fully aware that any deviation from the areas defined in this clause will be at the developer's own risk and for his cost.

Para. 1.1.2. A rigorous definition of the "building documents" is necessary to define the product being purchased by the investor as precisely as possible. Any deviation from the terms of these agreements, which by virtue of this definition clause are incorporated into the development agreement, will result in losses for the developer to the extent that he is not able to lay-off such losses with sub-contractors or negotiate his
In development where a rental guarantee has been agreed to, the investor retains far more control over the scheme. Either he or his property manager will collect the rent from the tenants, keep the records, administer and maintain the property.

Typically the investor would account to the developer on a monthly basis and in the event of any shortfall arising between the actual rent collected and the rent due in terms of the headlease, the investor would simply draw down the shortfall amount from the retention which he was holding against the developer for that purpose.

As noted earlier, it is very important that operating costs be accurately defined and a formula agreed upon to determine the level of unforeseen costs which may arise during the guarantee period.

The sample development agreement employs a rental guarantee, the basic terms of which are set out below.

**Para. 9.1.** In terms of this rental guarantee clause, the investor must deposit an amount equal to the lettable area multiplied by the net rentals defined in the agreement applicable for the first twelve months of the letting period (or whatever has been agreed as the period of the return which the developer is prepared to underwrite).

The deposit must be made into an interest bearing account from which the developer is entitled to interest, the rate and compounding intervals of which should be defined, payable monthly in arrears.
the rent roll, debtor control, expense schedule and leases.

One absolute requirement for managing some of the risk in a headlease agreement is a cession of the main lessor's rights to rental from the tenants of the building to the main lessor. This enables the investor or main lessor to step in and collect rentals the moment he identifies a problem with the main lessee's behaviour.

Ideally he should have a clause drafted into the development agreement and headlease entitling him to step in immediately he becomes aware of a problem with the way in which the main lessee is managing the property. At the very least there should be a requirement that all sub-leases be vetted by the investor, that the signed original sub-leases be lodged with the main lessor and that accurate books of account be delivered to the main lessor on at least a monthly basis.

It would also be prudent for the development agreement and headlease to contain a schedule specifying regular maintenance items and the frequency with which the investor expects the main lessee to attend to them.

To my mind a headlease is only appropriate where the development has a single tenant and is a relatively simple structure to manage.

The rental guarantee is more appropriate in the case of a speculative development or one in which there are several tenants and possibly several separate structures making up the scheme.
secure an initial return for a fixed period. This implies that the investor or its manager will be taking over the day to day running of the property once the headlease period expires and it should be noted that risks abound at this point.

The main lessee, might not have been collecting arrear rents, he might not have implemented rental escalation clauses and he even may not have had the sub-leases signed by the tenants.

It is quite possible that he would not have attended to any major cost maintenance items, particularly those which are not immediately visible such as painting a roof or treating woodwork. It is also not impossible that the main lessee collects rent from the tenants and fails to pay it over to the investor in terms of the main lease (this is actually theft, but has been known to occur).

The main lessee might not have kept accurate and up to date records of the property's income and expenses and where the property is held in a company, he might not have kept the books up to date or had them audited thus making it extremely difficult for the investor to form an accurate picture of the state of the property and understand the actual financial position of the buildings on expiry of the headlease.

Practically speaking, the only way for an investor to control a headlease and manage some of the risks which arise is for it to employ a property manager to shadow the activities of the main lessee although in itself this can be problematic where the main lessee is unco-operative and not forthcoming with details of
Para. 9. **Guarantee by the developer**

There are two major forms of guarantee which may be called for by the investor and these are a "headlease" or a "rental guarantee".

Looking first at the headlease we note that, the developer or vendor of the scheme is placed in the position of the investor as landlord or lessor and has total control over the administration of the property.

By definition, a headlease involves a main lease, the headlease, between the investor or main lessor and the developer/vendor who is the main lessee, as well as one or more subleases between the main lessee, who would be the sub-lessee for purposes of the sub-lease, and tenants of the building who would be the sub-lessees. The main lessee is usually responsible for collecting rent from each of the sub-lessees, ensuring that rental escalations are implemented on time, that operating costs are paid and that the building is maintained in a satisfactory condition. Where there is any shortfall between the rent collected from the sub-lessees, after deducting the maintenance costs of the building, and the amount due to the main lessor in terms of the headlease, the main lessee would have to pay in the difference to make up the headlease rental payment.

In terms of the main lease, all the investor, or main lessor, should have to worry about is the timely payment of the correct amount of rental due in terms of the headlease.

However, nothing could be further from the truth. Parties would typically sign a headlease where the investor buys the building/development and wants to
tenant. What this means is that where any negotiation takes place between the developer and the tenant and the developer wishes to yield some "financial ground", he, the developer, is liable for the cost of any such "ground" yielded.

- Where leases are agreed to by the developer and the investor and are concluded at rentals lower than the net rentals as defined in the agreement, the rent payable on the termination date of the rental guarantee period must be adjusted so as to be market related (i.e. an upwards only rental review inserted in the lease must be compulsorily implemented at this stage). The upward revision in the case of this sample development agreement is subject to the proviso that the minimum escalation is 12% on the rent payable for the previous 12 month period.

- Any lease negotiated must otherwise comply with the standard model lease appended to the development agreement.

This clause is necessary to ensure the greatest possible degree of certainty with regard to the future cash flow generated by the scheme. Developers and investors have different agendas as far as signing up tenants is concerned.

The developer seeks to minimise his liability for top up payments under a headlease or rental guarantee and the investor is interested in signing up quality tenants and providing them with the best possible premises and services so as to secure his future rental income stream.
Some provision needs to be made in the development agreement in which a formula is set out to determine who bears the cost of such longer leases.

It would seem to be fair to allow the investor to assume this risk since it is he who will benefit in the long run from the certain cash flow and the developer won't be inclined to reject the tenant because of the negative impact the additional letting commission payable would have on his development profit.

Para 8.3. This clause sets out the rules applicable to letting during the letting period which are as follows:

- Leases must be approved in writing by the investor.

- The investor may only approve leases which differ from the standard model, appended to the development agreement, where both the developer and investor have approved the financial standing of the tenant.

- Leases must run for a minimum period, in the case of this development, three years.

- The tenant must pay a pro-rata share of all costs and maintenance as set out in the draft lease attached to the agreement.

- The rent payable by the tenants must escalate by at least 12% per annum.

- Any costs associated with concluding the lease and any stamp duties are payable by the
the risk of another broker or agent levelling an unforeseen claim for commission against the investor.

As regulated by this agreement, other agents may bring tenants to the scheme, but will have to approach one of the joint sole agents and negotiate a commission split with them. This arrangement does carry the risk that other agents will be reluctant to expose their leads to the joint sole agents, who are their competitors in the industry, where there is the possibility that they might be unable to agree on a commission split and the joint sole agent then places the outside agent's client somewhere else. This may have the consequence of fewer tenants being introduced to the scheme than would otherwise be the case.

**Para. 8.2.** Sets the maximum letting commission payable by the developer. This will have been calculated using a specific period, say three years, with a fixed starting rental escalating at a fixed rate for the duration of the lease. The appropriate letting tariff would then be applied to the rental flow created by these notional leases.

Although this leaves the risk for any variation from the terms of the notional lease with the developer, in practice problems arise when for example a tenant requiring a substantially longer lease than the base period (i.e. 3 years) is encountered.

Whilst the tenant may be of the required quality and financial standing and the length of the lease may be highly desirable, the letting commission payable could conceivably consume the entire allowance in one fell swoop.
developer is obliged to pay the amount over to the recipients who are entitled to payment.

The payments are to be regulated so as to keep the number of payments required to a minimum.

This clause protects both the investor and developer alike. The investor is provided with proof of the progress of the scheme, although it is in his interests to have his own professional team double check the developer's architect's certificate, and the developer is provided with confirmation that progress payments may not be unreasonably delayed and with certainty of receiving money due within 7 days.

In terms of this clause, the investor's rights are clearly stated with regard to payment of contractors and the like by the developer. Although in practice the appropriate payments may not be made by the developer, as mentioned previously in this report, a clause authorising the developer to pay subcontractors and others directly where they have not been paid by the developer should be included.

Para. 7.5. In terms of this clause the developer is to deposit a specified amount as security for the development costs which is to be reconciled with the rental guarantee amount in terms of para. 8. (i.e. on the completion date or on the date when the total development cost is equal to 89% of the ceiling cost whichever occurs first).

Para. 8. Appointment of the letting agent

Para. 8.1. Records the appointment of certain, specific agents or firms as joint sole letting agents for the buildings in the scheme. This clause is important to eliminate
developer to manage their respective risks more effectively.

**Para. 7.2.** This clause contains a warranty that the total development cost will not exceed the ceiling cost and that if it should, the developer will pay whoever the money is due to and indemnifies the investor against any risk in this regard.

If the total development cost should be less than the ceiling cost then the difference will constitute development profit due to the developer on the completion date subject to the reconciliation of the various guarantee amounts put up by the developer in terms of the agreement.

**Para. 7.3.** Where the investor is liable to any third party in respect of any excess constituting development profit, then the investor may recover that amount from the developer immediately after the liability is incurred regardless of whether the third party has been paid by the investor yet.

This clause ensures that the liability for payment of a third party claim against the developer remains with the developer and is not shifted to the investor as a result of the timing of the payment of money over to the developer.

**Para. 7.4.** As far as managing the payment of the development cost is concerned, this clause states that the developer is to submit monthly statements supported by vouchers and architect's certificates to the investor's company.

The investor is to pay the amount required to the developer within 7 days of the request and the
agent claiming to have acted on behalf of one of the parties.

* Any other costs necessary for the completion and letting of the development.

* The costs of any fixtures, fittings and equipment installed in the building.

* Tenant installation costs and any other prime cost items subject to quantities and amounts specified in the design documents.

* Any deposit made by the developer to the investor to provide cover against possible shortfalls in the total development cost.

The amount of such a deposit would be specified and possible reductions in the amount of the deposit arising out of the receipt of net rental income from the premises prior to the completion date or from the receipt of the proceeds of any insurance policy pay-out received because of a delay in the completion of the project would also be specified.

In defining the total development cost, this clause instals additional security for the investor against the risk of possible non-performance or non-payment of persons working on the project by the developer. It also contributes to certainty for both parties as to what quantum of payment will be made for what services and enables both the investor and
• Professional fees.

• Payments due to contractors, subcontractors, local authorities and the Receiver of Revenue.

• Notional interest on any amounts forming part of the total development costs disbursed by the investor and calculated at 12% per annum, capitalised monthly in arrears, from the date of each disbursement until the completion date.

It is important to specify the exact method of calculation of this notional interest, especially stating the compounding intervals, since there are many different methods of calculating interest.

• Legal costs, stamp duty and VAT.

• Insurance premiums.

• Letting commission on the first letting of all premises throughout the building in the scheme.

• Any placement fees or commissions due to an agent who introduced the scheme to the investor.

The name of the agent and the exact amount of the commission due should be stated. If no agent was responsible for an introductory fee, this should be stated in the agreement to avoid later claims by an
company. Once prepared, the documents must be approved by the company.

A procedure is set out for material deviations deemed to be necessary by the developer. Any alteration or deviation to the building documents must be signed by both parties and appended to the building documents thereby becoming part of the development agreement.

Unless specifically agreed to in writing in an alteration to the building documents, no amendment will affect the selling cost of the development. Other than by using the provisions of this clause, the building documents may not be altered in any way.

The function of the clause is to state unambiguously the nature of the product which the investor is acquiring and to ensure that no changes in the nature of the product occur without the investor’s blessing and agreement. It also ensures that there are no variations to the cost of the scheme without the investor’s consent.

**Para. 7.** *Total development costs*

**Para. 7.1.** This clause begins with a definition of the "total development costs" which includes the following:

- The total purchase price in terms of the vendor’s agreement including the cost of the land.
- Costs of "betterment".
- Costs of the development including:
investor, are shifted from the investor to the developer through the development agreement.

- Individuals and firms making up the professional team are not afforded any protection through the development agreement, other than to the extent that their appointment is confirmed and agreed to by the investor. These parties need to enter into independent contracts with the developer to ensure payment and to prescribe the extent of their services due.

- Where there is a third party such as the seller of the land on which the development is to take place, such a seller is not protected by the development agreement other than to the extent that the land sale agreement negotiated with the developer or investor is attached to the development agreement. Normally such a vendor would have his own attorney represent him in the drafting of the land sale agreement and payment of the purchase price would usually occur on transfer of the land to the new owner.

- Letting agents are covered by the development agreement to the extent that they are nominated as having certain rights with regard to being sole agents and are therefore entitled to share commission with any other agent bringing a potential tenant to the scheme.

- The property manager is not covered by the agreement and should enter into a separate property management agreement with the investor to regulate that relationship.

3.4. Effect of the power and of the relative positions of strength of the parties to a development agreement

The relative position of strength of the various parties to the development agreement is largely determined by the timing of the scheme, the skill or service which each party has to offer and the
- non-recovery of funds disbursed where no value is given in return

- a lower than expected return due to:
  - slower than anticipated letting,
  - not achieving anticipated rentals,
  - [other reasons]

Both the investor and the developer achieve certainty through the agency of this agreement and where possible will lay off further risk by the use of insurance.

Whilst the developer and investor are covered against risks they might experience during the development process, parties left vulnerable by the agreement are:

- The main contractor who only has recourse against the developer even though the funds being used to pay him are sourced from the Investor. The building agreement which is attached to the development agreement is largely there for the protection of the Investor, not the contractor.

Although not covered by the development agreement, the main contractor can minimise his major risk, that of not being paid by the developer, by maintaining regular contact with the Investor and ensuring that both the investor and he are sure that money is being disbursed for the correct purposes.

The contractor's other risks such as ensuring the supply of materials and the timely performance of construction work, the consequences of which ultimately rest with the
Para. 24. Developer no agent

This clause records that the developer is not an agent or partner of the investor's property owning company and has no authority to act on behalf of or to bind the credit of the company.

Such a clause is necessary to prevent the developer from incurring any liability on behalf of the investor without the investor's knowledge.

3.3. Parties protected and those left vulnerable by the sample development agreement

One needs to bear in mind that the sample agreement was drafted by an investor primarily for the protection of that investor. Areas of the agreement which indicate an advantage to the developer have occurred where it was expedient for or in the interests of the investor to agree to such advantages or where the developer would not agree to the scheme without that protection or clarity of risk.

Nevertheless, the negotiation has resulted in a document which clearly allocates responsibility for the many risks generated by the property development process to that party which both parties agreed should bear the risk as discussed during the negotiation and drafting phase of the agreement.

The major category of risk against which the investor enjoys cover in terms of the agreement is financial and the major events giving rise to financial loss are as follows:

- delay,
- loss through theft or damage,
- claims for damages to property or persons,
company many of which have departments specifically dealing with this type of cover.

Para. 18.2. All policies are subject to the right of inspection by and the approval of the investor.

Para. 18.3. Premiums and stamp duties form part of the development cost and are payable by the developer.

Para. 18.4. The developer is liable for any excess payable unless the event precipitating the claim occurred after the completion date.

Para. 18.5. Where the developer fails to insure, the investor has the right to insure on his behalf and to debit the developer with the cost.

Para. 18.7. In the event of any physical destruction, damage or loss, the developer is liable to make good any such damage and this obligation exists regardless of the existence of any insurance claim or delay in the settlement of an insurance claim.

Para. 19. *Risk and handing over*

This clause sets out the hand over procedure and states that the risk in the development passes from the developer to the investor on the completion date.

The final completion certificate, as distinct from the completion date, will be issued by the architect on termination of the maintenance period provided that all defects on the defect list have been rectified.
the investor. It is thus up to the investor to ensure that the requisite cover is taken out by the developer.

To this end the following types of cover are specified:

- **Contract works**
- **Public liability (contract works)**
- **Public liability (property owner’s liability)**
- **Insurance against loss arising from the removal of lateral support and piling if such removal is deemed necessary by the architect**

- The following forms of contract insurance are required until the end of the maintenance period:
  - Cover in terms of the Workmen’s Compensation Act.
  - Employer’s common law liability insurance.
  - Insurance of construction plant, equipment and temporary structures.
  - Motor vehicle insurance in accordance with the Compulsory Motor Vehicle Insurance Act and cover for balance of third party including liability for passengers.

The amount of cover to be taken should be determined with the aid of a reputable insurance company.
The architect may deliver to the developer additional lists of defects which the developer is required to rectify as expeditiously as possible with as little disruption to the tenants as possible.

Should the developer fail to rectify the defects identified within a reasonable time then the investor is required to give him written notice and failing subsequent rectification by the developer the investor may have the defect rectified itself or allow the tenant/s affected to rectify the defect and to recover the costs from the developer.

This clause clearly describes the risks borne by the respective parties.

Para. 16. Commission

Any placing commission (i.e. commission payable to the party introducing the scheme to the ultimate buyer) due to any party should be recorded in this agreement and the amount, time and place of payment should be specified.

Para. 18. Insurance

Insurance in development projects is an essential risk management tool, claims for damages could run into millions of Rands and there are few developers or investors who could bear the cost of a major claim.

In reality, although the risk is laid off by the investor to the developer through the agency of this agreement, the actual risk still remains with the owner of the land which in the sample development agreement happens to be the company owned by
Para. 12.4. Indemnifies the investor against defect, damage, loss or claims suffered by the developer as a result of the investor or its representative exercising its rights of inspection.

Para. 12.5. The investor may rely on its full rights in terms of this agreement at all times regardless of whether or not it exercised all or any of its rights of inspection as set out in this clause.

The importance of this clause cannot be stressed sufficiently for it is the only way in which the investor can keep track of the progress of the scheme and ensure physical adherence to the terms of the development agreement. It is also important for the developer in that the continued presence of the investor or his representative will dissuade the developer from the temptation to “cut corners” and not adhere to the building regulations and specifications.

Para. 13. **Indemnity**

This is a comprehensive indemnity clause typical to many different types of agreement which shifts the risk of claims for any loss or damages onto the shoulders of the developer who is required to insure against these risks.

Para. 15. **Defect list**

Here the developer is made aware of the fact that he will bear the risk for the rectification of any defects identified during the inspection by the developer, the investor and the architect within seven days of the completion date.
**Para. 11.4.** Allows the developer to negotiate directly with the tenants concerned to recover any overrun in the installation costs against the budget. The investor needs to be aware here that the developer may frighten off a potential tenant by insisting that it pick up the extra cost for any installation and it may be prudent to include a clause requiring the investor's approval of the proposed terms of such a negotiation before it is commenced.

**Para. 11.5.** Gives the investor the right to control the "development retention" funds.

**Para. 12. Inspection rights**

**Para. 12.1.** The investor has the right to look at the land, buildings and building documents as well as the books and records of the developer which are relevant to the scheme.

**Para. 12.2.** The investor may appoint a "watching brief" representative, at the developer's cost which will not exceed a specified Rand amount, to exercise the investor's rights of inspection. The developer is obliged to render all necessary assistance, cooperation and information to the investor's representative.

**Para. 12.3.** The investor is entitled to draw the attention of the developer to non-compliance with provisions of this agreement, particularly with reference to the erection of the building and the developer is obliged to rectify where necessary failing which a dispute will be declared for resolution in terms of the arbitration clause contained in the agreement (para. 14.).
the fitting out and installation of the last tenant's premises.

The escalation in the cost of the installation has to be borne by one of the parties and the interest earned on any retention held may not be sufficient to cover the rise in the installation costs. It is also only fair to put some sort of limit on the developer's liability for any rise in installation costs over time.

It is necessary to set out some sort of procedure for hiring sub-contractors to do the installation work given that the developer's building team may have been off the site for quite some time and not able to do the work when the last tenant comes to be installed.

The developer is at risk from the point of view that should the Investor complete this aspect of the project, the Investor may hire a very expensive contractor and may not have the ability to source materials as cheaply as the developer could. These issues are not addressed in the sample agreement and need to be specifically dealt with.

Para. 11.2. This clause makes provision for the ceiling cost to be reduced by the amount of the installation allowance that has not been used by the completion date.

Para. 11.3. Here, the agreement provides for the architect to prepare an estimate of those amounts "reasonably necessary" to install the rest of the tenants in the building and of any outstanding payments to contractors and the like. This is to enable the investor and developer each to do their own reconciliations of the amount required to create the "development retention" to be held by the investor.
**Para. 10. The Initial return**

Here the developer guarantees the "initial return" as defined in the definition section of the agreement. The guarantee is for the duration of the letting period and the developer indemnifies the Investor against any loss during this period. The developer also records that its liability in respect of the initial return is limited to the amount referred to in para. 9, i.e. the rental guarantee amount.

Whilst the primary purpose of this clause is the elimination of the Investor's risk of not achieving the guaranteed initial return which was one of the conditions under which he agreed to purchase and finance the scheme, it also limits the potential liability of the developer arising from the guarantee.

**Para. 11. Tenant installations**

In terms of the sample agreement, the tenant installation work is costed into the total development price and the only risk that exists is that of a shortfall arising between the budgeted amount and the actual cost incurred.

This agreement uses the rental guarantee retention amount to cover any such shortfall between the tenant installation allowance budgeted for in the initial costing of the scheme and the actual cost of fitting out the first tenants throughout the building.

It is very important that the specifications for the tenant's installations be accurately described and costed because almost inevitably there will be some delay between completion of the development and
The developer may argue that he is unable to minimise potential losses arising out of the rental guarantee where he is unable to negotiate the terms of the leases more freely and that he should be able to collect the rentals and generally manage the costs of the building during the letting period. A direct conflict of interests exists between the developer and investor at this stage and the investor needs to retain control of the tenants and running costs of the building at all times.

This conflict of interests arises because the developer seeks to fill the building with tenants without delay so as to allow his rental guarantee amount retained by the owner to be released and paid out to him. In my experience this imperative makes the developer less discerning in respect of the quality of the tenant, the tenant’s financial soundness, the likely use of the premises, the compatibility of the proposed new tenant with other existing tenants in the building. For example, it is not ideal to put a noisy, messy, fume generating steel frame construction company with its inevitable welding and painting operations into a mini factory unit next to a high-tech manufacturer of sterile eye care products such as contact lenses.

On the other hand, the owner is interested in having long term good quality tenants who will not antagonise the other occupants of the building thereby jeopardising the strength and consistency of his future cash flows from the property. The owner is thus likely to reject many of the proposed tenants put forward by the developer and this leads to conflict which is usually resolved by a process of compromise.
The deposit may be reduced pro-rata at the investor's sole discretion having regard to the quality and duration of the leases entered into and as to the space remaining unlet during the letting period.

Para. 9.2. The developer may put up a bank guarantee of cash for the rental guarantee and the inclusion of this clause will depend upon the investor's perception of the developer's financial standing at the time the development agreement is concluded.

This rental guarantee clause is pivotal in allocating risk between the investor and developer. Often the development is not fully let during the letting period and the entire amount of the rental guarantee can be used up in providing the investor with a guaranteed minimum return for a period.

An omission in this sample development agreement is a clause categorically stating that there is no cession of the investor's rights as landlord, to the developer.

Although it is tacitly understood from the terms of the sample agreement that the investor is the landlord and as such enjoys all of the landlord's rights, the conflict of interests which arises in the letting phase may call this aspect of the legal relationship into question.

In the case of a headlease it is absolutely essential that a cession of the landlord's rights from the developer/main lessee to the investor/main lessor be included in the development agreement or headlease itself.
The numbers on the chart above are reinforced by the statistics for the second part of the question in which the respondents were asked to indicate what percentage of their business is represented by each property category and where the average results for the sample were as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial</td>
<td>45%</td>
</tr>
<tr>
<td>Retail</td>
<td>30%</td>
</tr>
<tr>
<td>Industrial</td>
<td>18%</td>
</tr>
<tr>
<td>Residential</td>
<td>7%</td>
</tr>
</tbody>
</table>

**Question 3**

"What is the average minimum value of individual property development projects usually dealt with by your firm?"

The chart clearly shows that the bulk of the respondents' development business is with schemes having a minimum value in the R5m to R20m range. One would expect schemes of this sort of size to warrant the cost of negotiating and drafting a property development agreement.
This response also indicates that the opinion of the correct sample is being sought in connection with the property development agreement (i.e. people directly involved as principals in the property development process such as property developers and property investors and managers).

**Question 2**

"Type of property development schemes that your firm typically deals with (please tick the appropriate box or boxes and indicate that percentage of business which each type represents in the second column of boxes):"

![Pie chart]

<table>
<thead>
<tr>
<th>Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>11%</td>
</tr>
<tr>
<td>Commercial</td>
<td>33%</td>
</tr>
<tr>
<td>Retail</td>
<td>30%</td>
</tr>
<tr>
<td>Industrial</td>
<td>25%</td>
</tr>
</tbody>
</table>

Fairly even proportions of the respondents are exposed to commercial (offices), retail and industrial property business with only 11% having exposure to residential property. Again, this confirms that the sample is appropriate in that one would not generally expect development agreements to be signed in the case of residential developments which are typically lower in value and where there are usually a greater number of smaller purchasers than in the case of development projects in the other categories.
exclusive. However, in some cases only one part of the question has been answered and where this has occurred an opposite response (yes or no) has been assumed for the alternative portion of the question on the grounds that the majority of the population sample has responded as anticipated.

Where percentages are shown, these may have been rounded up or down to the nearest percent.

4.2. Analysis of the actual responses to the questions

Question 1

Respondents were asked to indicate the primary business of their company from the following alternatives: property development, construction, property investment and management, letting or other.

As can be seen from the chart above, the bulk of the respondents are active in the property development and investment and management fields with the smaller part of the sample correctly reflecting the construction companies and attorney's firms (other).
two firms of attorneys, two professional property firms, one investor and one developer failing to respond.

Not all respondents answered the questionnaires in the same way and in some cases inapplicable questions were left blank or answered under the "other (please specify)" space provided for alternative answers.

Apart from question 9, the answers have been evaluated by adding up the number of responses to a specified alternative answer and then calculating the percentage which that number bears to the total number of responses received for that entire question.

In question 9 where the respondents were given a range of 20 alternative risks from which to rank their personal top ten in order of priority with 1 representing the highest risk and 10 the lowest, only 25 of the 41 respondents completed the question correctly so the sample was limited to 60% of the total number of questionnaires sent out.

In question 9 the results were analysed by adding up the total value of the numbers allocated to each risk by all 25 of the respondents. Blank spaces were deemed to have a value of 11 on the assumption that if no number had been given to a particular risk then that risk should bear a value higher than 10 since 10 was the lowest priority attributable to any identified risk. Once the addition had been completed the results were ranked with the lowest total representing the highest risk and the highest total representing the lowest risk as perceived by the 25 respondents.

In questions 15, 16 and 20 there is provision for two alternative yes/no answers. When preparing the questions it was intended that the alternative answers be mutually
Questions 1 to 3 categorise the respondents in terms of the type and scale of work undertaken by their firms.

Questions 4 to 8 deal with their understanding of the nature of the property development agreement whilst question 9 looks to obtain a ranking of the top 10 risks inherent in the property development process.

Questions 10 to 23 assess how the risks are normally managed and how performance is usually secured from the parties to a property development transaction.

Question 24 assesses how comprehensive the documentation typically is in a property development agreement and questions 25 to 31 cover specific issues relating to the rental guarantee mechanism.

Question 32 examines the concept of "net return" and question 33 seeks to establish how the "return" from a development project is usually calculated.

4.1.2. Explanation of the sample and comment on response

Of the 50 questionnaires sent out, 10 went to investors, 16 to developers, 9 to construction companies with a development profile, 6 to firms of attorneys with expertise in drafting property development agreements and 9 to professional property firms such as letting agents who are involved in the development process.

The purpose of sending the questionnaire to such a diverse sample was to obtain a response from a broad and as representative as possible cross-section of operators in the property development industry.

Overall, the response from 41 participants or 82% of the sample was high with only three construction companies,
Chapter 4.
Market survey

4.1. Methodology

The survey was conducted entirely by means of a questionnaire containing 33 questions sent out to a sample of 50 operators in the property industry. The questionnaire was transmitted by fax machine and numerous telephone calls were made to the respondents to ensure their co-operation and to explain any questions which might have been misunderstood.

4.1.1 Aim of the research and structure of the questionnaire

It is intended that the research should enable the reader to assess the property market's understanding of the property development agreement, its purpose, between whom it is entered into, who benefits from signing it and whether or not it is relevant and necessary.

In addition, the research should ascertain what the market views as the major risks inherent in the property development process and it should enable one to rank those risks.

It should provide an indication of how the major risks are normally managed and how performance is typically ensured in the property development process.

Finally, the fieldwork should obtain a market view on a number of specific issues often covered by clauses in development agreements.

The questionnaire has been structured in the following way:
commission to be paid to estate agents introducing those tenants to the development.

3.6.5. Omission of a provision for measurement of the building after the construction work has been completed according to an internationally acceptable measuring standard and for the purchase price of the scheme to be adjusted upwards or downwards according to that final measurement.

3.6.5. Leaving undefined the issue of ownership of any retained portion of the development cost in the event of insolvency or other change in status of the developer.

3.6.7. Similar to 3.6.6. above in not providing a mechanism for keeping the agreement alive in the event of conditions precedent not being fulfilled because of some change in status of the developer (e.g., insolvency).

3.6.8. Not drafting a clause preventing the developer from giving professionals, particularly the architect, an incomplete brief, thereby releasing e.g. the architect from professional responsibility for the project and not requiring him to use his full skills to ensure that the project is built as designed.

3.6.9. Not determining precisely what accounting method is to be used in calculating the net return for purposes of the rental guarantee duration calculation.
equal time and effort should be devoted to negotiating a
settlement or compromise.

As may be seen by the answer to question 23 in the
questionnaire (page 123 below) i.e. "What do you believe
to be the most cost effective method of ensuring
performance in a property development project", where
70% of the respondents indicated that they believed
negotiation and agreement to be the most cost effective
method.

3.6. Typical shortcomings of existing development agreements

In my experience, the following shortcomings appear regularly in
property development agreements.

3.6.1. Non-inclusion of a full description of operating costs in the
definition of net return.

3.6.2. Failure to make provision for direct payment by the
investor to sub-contractors in the event of the developer
experiencing financial difficulties or not making payment to
contractors and professionals as set out in the
development agreement or as necessary for the timeous
completion of the project.

3.6.3. Failure to include a cession of the developer’s or vendor’s
rights to collect rental directly from tenants in terms of a
headlease or rental guarantee.

3.6.4. Failure to provide for the situation where letting the
building(s) in the development takes longer than originally
envisaged and more specifically, longer than the rental
guarantee period. A formula needs to be included to
ensure sufficient funds are provided for installation of the
first tenants throughout the building and for letting
This form of enforcement is fairly drastic and would usually only be utilised where relations between the investor and developer had broken down irretrievably or the developer had become insolvent.

Substituting or replacing the developer also requires that the accounts with the defaulting developer are finalised whilst a new set is established with the succeeding developer. This only serves to complicate the transaction even further.

3.6.2. How practical are those methods?

All of the above methods are effective in their specific sphere of use, but all carry a delay factor and consequently a cost apart from the legal costs of conducting a hearing or court case.

From a practical point of view the aggrieved party will have to weigh up the cost of bringing the action against the cost of remedying the defective or non-performance in some other manner.

Also, much time, money and potential conflict can be saved and avoided by the investor closely monitoring the progress of the development and by retaining the services of a professional such as a "watching brief" quantity surveyor to ensure that action is taken immediately any deviation from the terms of the agreement is detected.

3.5.3. How cost effective are those methods?

In my experience as an investor, barring the discipline of closely monitoring the project, none of the above methods is cost effective and every effort should be made to cover any possible area of dispute or misunderstanding by including it in the development agreement and falling that,
parties to the negotiation process leading to the signing of a development agreement.

3.5. Enforcement of rights arising out of property development agreements

3.5.1. What are the usual methods of enforcement?

Firstly there are the dispute resolution procedures outlined in the development agreement. These could provide for a decision by an expert or for arbitration proceedings or for the matter to be heard in the Magistrate's Court or in the Supreme Court.

Usually the agreement would provide for a period of time within which the transgressing party has the opportunity to adhere to the specific term of the agreement from which it had deviated or to make good any damage caused. Only in the event of the position not being rectified or where the remedial work is unsatisfactory would the aggrieved party declare a dispute and then follow the procedures as set out in the agreement.

That is the formal method. Informally, it is the investor who controls the cash flow and consequently has the ability to turn the cash tap on or off to a certain extent depending upon the performance of the developer. This is another method of enforcing the terms of a development agreement, but usually only occurs where the investor believes it runs the risk of losing money by paying it over to the developer.

In certain instances the investor may appoint another developer or contractor to step in and complete the project or some aspect of the project where the developer has breached a term of the agreement and failed to rectify that breach within the allotted time.
The tenant, depending upon its size, perceived financial standing and quality, length of lease desired, and timing in the property cycle, will have a greater or lesser bargaining strength when negotiating a lease.

Other issues which will affect the relative positions of strength of the respective parties are:

- The timing of the scheme within the current property cycle (i.e. if the project is due for commencement when the property cycle is in an upswing, the professionals will have plenty of work on their hands and will only take on attractive and lucrative projects, the developer will probably have a number of investors interested in the scheme and the investor will be negotiating from a position of relative weakness. The converse applies during downswings in the cycle.)

- The quality of any proposed tenant and consequently the strength and likely duration of any future income stream anticipated from the project.

- The inherent characteristics of the property proposed for development will make it more or less desirable and will consequently influence the ability of the developer to sign a development agreement on the most favourable terms, e.g. with no rental guarantee, and on terms which would most securely limit his downside risk in the project.

Typical characteristics would be: location, topography of the site, uniqueness of the scheme, availability of parking, aesthetic appeal, proximity of desirable or undesirable features and facilities and versatility of design from the point of view of possible tenant layouts.

Depending upon the interplay of the above factors each of the participants will have varying degrees of influence over the other
scarcity or availability of those skills or services. The skills, services or products offered by the various parties are as follows:

- The investor has money or the ability to arrange finance which will enable the scheme to proceed and will require a return on any money disbursed.

- The developer has a scheme which he wishes to sell in order to make a profit for himself and he may or may not have a track record of similar schemes successfully completed.

- The landowner has ownership of the site desired for the development.

- The letting agent either has a tenant lined up with a signed "in principle" letter indicating that if the scheme is completed within a certain time and according to certain design specifications, that tenant will enter into a lease for premises in the scheme, or it will have an established client base and a track record of regularly and quickly being able to identify any potential new tenants as soon as they come into the letting market.

- The professionals and consultants will have a reputation, track record, the capacity to handle the volume of work generated by the particular development being considered and not least of all, preferably an established professional relationship with either the developer or investor, to secure their place in the professional team.

- The property manager will have a track record in the industry, good computer systems, a letting and debt collection capability, maintenance personnel and also the capacity to take on the work at the time.
Question 13

"Do you believe that the full services of an architect, including supervision, should be retained in all development projects?"

<table>
<thead>
<tr>
<th></th>
<th>Yes 48%</th>
<th>No 52%</th>
</tr>
</thead>
</table>

With a split of 48% for and 52% against the retention of the full services of an architect, including supervision, in all development projects, no clear conclusion can be drawn from this response save that the issue is far from decided and that the architect's brief and role should be agreed and recorded in a development agreement to avoid confusion over his actual responsibilities on the project.
61% of the participants in the field survey do not believe it is more beneficial for a developer to enter into a turnkey (package deal) contract with one contractor instead of entering into various separate contracts with individual professionals, consultants and contractors.

This response leads to the possible conclusion that a development agreement would be useful in enabling an investor to agree on the appointment of all the various professionals, consultants and contractors and in building in a mechanism to allow them to be paid to continue the job should the developer run into any financial difficulties.
Question 11

"Do you believe it is necessary for the investor/financier to employ a "watching brief" quantity surveyor in addition to the project quantity surveyor to protect its interests?"

The majority of respondents did not believe it necessary for the investor/financier to employ a "watching brief" quantity surveyor in addition to the project quantity surveyor to protect its interests.

Question 12

"Do you believe it is more beneficial for a developer to enter into a turnkey (package deal) contract with one contractor instead of entering into various separate contracts with individual professionals, consultants and contractors?"
Question 10

"In your opinion, who should be responsible for ensuring that the project is fully insured during the development phase before handover to the investor/purchaser?:"

<table>
<thead>
<tr>
<th>Bldr.</th>
<th>Inv'tr.</th>
<th>Dev'r.</th>
</tr>
</thead>
<tbody>
<tr>
<td>15%</td>
<td>20%</td>
<td>65%</td>
</tr>
</tbody>
</table>

Nearly two-thirds of the respondents felt that the developer should be responsible for ensuring that the project is fully insured during the development phase before handover to the investor/purchaser. Only 20% believed insurance to be the investor's responsibility and 15% thought cover should be the responsibility of the builder. This response indicates that there is a measure of uncertainty over who bears responsibility for insuring the project. Such uncertainty can be avoided by inclusion of a clause allocating responsibility in the development agreement.
respondents felt that insurance was covered by the identification of construction risk.

It is also surprising to find risks 15, 17 and 19 listed above so far down in the rankings. I would have thought that no. 15, uncertainty regarding the terms of the transaction between the developer and the investor, was a fairly crucial determinant in the success of a property development scheme, but perhaps it is not perceived to be a risk until problems arise with a scheme. No. 17, inefficient tax structuring of the scheme, is also capable of making a significant hole in the potential profitability of and return from a development. No. 19, overpayment of the developer in relation to the construction work completed is perhaps more understandable since it is unlikely to have been perceived as a risk by any of the developers. In fact only one developer respondent saw this as a risk worth rating.

Other risks noted, but not rated by the respondents include: the location of the development, market research proving to be incorrect, external competition, political unrest and uncertainty, future tax legislation, control of the professional team, control of payments made by the developer to sub-contractors, an inexperienced property developer, acceptance of the project by tenants, long term unpredictable changes, location of the site and any delay in the provision of services e.g. telephones.
The risks of budgeted rentals not being achieved and letting proceed more slowly than anticipated can both be controlled by means of a rental guarantee or head lease mechanism, either of which are typically included in a development agreement.

Responsibility for any negative consequences flowing from an inappropriate building design can be clearly allocated and understood by the parties through provision in the development agreement and certainty as to what is being built can be achieved by including the design documents and drawings as an annexure to the agreement.

Inaccurate estimation of the end value of a scheme can be avoided by including a provision for remeasurement of the building on completion of construction, agreement as to the appointment of the quantity surveyor to the project as well as a watching brief quantity surveyor and the inclusion of the agreed cost estimates in the development agreement.

Uncertainty as to who should bear the risk of poor quality construction and project supervision can be avoided by agreement and the actual risk of poor quality construction can also be limited by agreement on the selection of the professional team and as to the role of the architect or project manager to the scheme.

Construction risk can be understood and apportioned by agreement and better defined by inclusion of the building contract in the development agreement. The risk can be limited by the use of insurance, the responsibility for which can also be clearly stated in a development agreement.

Of the remaining lower ranked risks, the lowest (failure to take out adequate insurance for the project) bears mention. It seems surprising that this is regarded as such a minimal risk especially given that most of the response to the question was evenly split between investors and developers, it is possible that the
13. Insolvency of the developer, financier/investor or the builder

14. Problems with the cash flow from the financier/investor to the developer

15. Uncertainty regarding the terms of the transaction between the developer and the investor

16. Incorrect measurement of the lettable area in the building

17. Inefficient tax structuring of the scheme

18. Uncertainty regarding the relationships between individual investors comprising a consortium owning a property development

19. Overpayment of the developer in relation to under-construction work completed

20. Failure to take out adequate insurance cover for the project

Of the top ten risks ranked, only three (nos. 1, 3 and 9 in the list above) cannot be managed through the agency of a written development agreement. These three are circumstantial risks determined by the investment environment prevailing at the time the development is proposed and executed and are beyond the direct control of any of the parties.

The other seven all fall within the purview of the development agreement. Securing appropriate and desired rights for the site can be controlled by the inclusion of a condition precedent in the agreement thereby leaving the risk with the developer assuming that is the intention of the parties.
Question 9

"Please indicate in numbered order of priority (where 1 is the highest priority and 10 is the lowest priority) which of the following circumstances you believe comprise the top ten major risks inherent in the property development process:

The respondents ranked the 20 suggested risks in the following order where 1 represents the highest risk:

1. Timing of the scheme within the property and economic cycles
2. Securing the appropriate and desired rights for the site
3. Finding a buyer/investor for the scheme
4. Achieving budgeted rentals
5. Letting proceedings slower than anticipated
6. Inappropriateness of the building design
7. Inaccuracy in estimation of the end value of the scheme
8. Poor quality construction and project supervision
9. Financing bridging finance to proceed with the scheme whilst looking for long term finance or an investor
10. Construction risk (e.g. works risk, delay, labour action, weather, materials shortages etc.)
11. Unforeseen building cost escalations
12. Implementation of penalty clauses and other controls such as rental guarantees and headleases
100% of the respondents believe that a written development agreement is absolutely essential in managing the risks inherent in the property development process.

**Question 8**

"In property development schemes where your firm is involved, is a written property development agreement concluded:

- always
- sometimes (please indicate the approximate % of times such agreements are concluded)"

![Graph showing responses for Question 8]

Although not unanimous as in Question 7 above, 93% of the respondents always conclude a written property development agreement. Those who only sometimes conclude such agreements nevertheless sign written development agreements 65% of the time, on average.

These two questions 7 and 8 demonstrate that the market views the property development agreement as a vital document which is drawn up and signed for practically every development project embarked upon.
Question 6

"Which party do you believe is most protected by and benefits most from the negotiation and conclusion of a development agreement?"

The respondents were strongly in agreement that the investor is the primary beneficiary of the conclusion of a property development agreement with some (25%) believing that the developer also benefits.

Question 7

"From the point of view of managing the risks inherent in the property development process do you believe that a written development agreement is:

- absolutely essential
- an expensive luxury
- totally unnecessary"
**Question 5**

"When negotiating the acquisition or sale of a property development scheme, what is your preferred vehicle for holding the land?"

Far and away the majority of the respondents prefer to hold the land in a development project in a private company. This would indicate that they prefer the convenience of dealing with a separate legal entity and despite a possibly more onerous tax position prefer to separate the risk in development from the individuals managing those companies.
**Question 4**

"Assuming that the vendor of the land, the builder, developer, architect and investor/financier are all separate parties to a property development project, who do you understand the property development agreement to be transacted between?:"

This chart provides strong evidence of the fact that most of the respondents understand the development agreement to be between the investor and developer.
Question 23

"Following on from question 22 above, what do you believe to be the most cost effective method of ensuring performance in a property development project?"

The chart shows an overwhelming majority vote of 71% in favour of negotiation and agreement as the most cost effective method of ensuring performance in a property development project followed by cash flow manipulation with 27% support. The "other" response was that the most cost effective method was "a proper development agreement in the first place".

The response to this question gives a clear mandate for the negotiation of a development agreement as the most cost effective method of ensuring performance in a property development project.
Question 22

"In your experience, how are the rights flowing from a property development transaction usually enforced during and after completion of the project?"

The chart above graphically illustrates the market's consensus on the use of cash flow control to the developer as a means of enforcing the rights flowing from a property development transaction during and after completion of the project.

Arbitration found a measure of support at 28% with litigation clearly a last resort at 2%. Other methods suggested include negotiation, agreement and one respondent observed that "The reputation of the developer is paramount. If he is known in the market as someone who doesn't meet his commitments, he is dead!".

One conclusion that can be drawn from this result is that the legal process is too costly, complicated and time consuming so the practical, effective alternative of withholding payment is preferred.
Question 21

"Which of the following forms of cover do you prefer to use to ensure performance and to secure the agreed return from a property development scheme?"

As may be seen from the chart above, the sample population of property industry operators far and away prefers to use a rental guarantee to ensure performance and to secure the agreed return from a property development scheme.

One respondent stated that there is no one method of ensuring performance and that the form of any guarantee depends upon the nature of the development. Other forms of retention noted were phased payment proportionate to the leases concluded and "adequate leasing control prior to completion to ensure valid, binding leases to ensure returns are as agreed".
"or do you treat the retention as part of the purchase price or part of a fee payable to the developer, and consequently legally owned by the developer, and then hold it in trust until it is consumed or until the expiry of the guarantee or retention period (yes/no)?"

53% of the respondents came out against treating the retention as money legally owned by the investor and 55% voted in favour of treating the retention as part of the purchase price or fee payable to the developer E.J therefore as being legally owned by the developer whilst held in trust until consumed or the guarantee period expires.

Although tax effective, the one drawback with this alternative is that if the developer becomes insolvent, the investor is simply a concurrent creditor for the money due to it in terms of any rental guarantee.

The reason for the difference in percentages between the two alternative answers to the question is that one of the respondents answered yes to both sections of the question indicating at the second section that the way the retention is treated "depends on the purchaser of the development".
Question 20

"When negotiating the terms of a development agreement, in which a retention is agreed upon for purposes of a rental guarantee, future tenant installation costs, letting commission, completion of construction or for any other reason, do you treat the retention as money which is legally owned by the investor until such time as it is consumed in terms of the agreement or the agreed retention period has expired (yes/no)?"
Question 19

"When negotiating the terms of a development agreement, do you make provision for direct payment to be made to subcontractors by the investor if the developer runs into financial difficulties or for whatever reason fails to make any payment due to any of the subcontractors working on the development? (yes/no)."

The 56% majority vote indicating that such provision is not made seems to provide evidence that this is an area which is generally overlooked by the signatories to development agreements and needs to be considered when negotiating such agreements.
Question 18

"Where you enter into a headlease do you ensure that it contains a clause cancelling any cession, from the purchaser/head lessee to the developer/vendor/head lessee, of the property owner's rights as landlord in respect of tenants actually occupying the building? (yes/no)."

The 52% vote in favour indicates that marginally more respondents do make sure that any headlease contains a clause cancelling any cession of rights from the head lessor to the head lessee than those who don't, but the market seems fairly ambivalent on this issue.
Question 17

"When negotiating the purchase or sale price of a property development project, do you provide for the lettable area of the building, on which the purchase price is based, to be measured on completion and for the purchase price to be adjusted accordingly? (yes/no)."

59% voted in favour of remeasurement and purchase price adjustment on completion.
"or do you prefer to enter into a fixed price lump sum tender (i.e. not subject to remeasurement) (yes/no)?"

With 55% in favour of a provisional contract price subject to remeasurement and against entering into a fixed price lump sum tender it would seem that the market has a marginal preference for provisional contract pricing subject to remeasurement and valuation.

Again, one respondent answered yes to both alternatives qualifying the second yes by stating "sometimes depending on market climate" and another answered no to both alternatives thereby indicating that some other method of contract pricing is employed.
that historical relationships and the track record of known contractors makes them the preferred choice over an unknown entity which may win a tender on the basis of price alone.

One respondent answered no to both alternatives and indicated that it preferred entering a contract using a selected tender method. Another response gave yes to both alternatives indicating that both methods are employed depending upon prevailing market circumstances.

**Question 16**

"Once the contractor has been identified, do you prefer to enter into a contract based on a provisional contract price subject to remeasurement and valuation (yes/no)?"

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>55%</td>
<td>45%</td>
</tr>
</tbody>
</table>
Question 15

"When developing a property do you prefer to enter into a negotiated contract with a contractor of your choice (yes/no)?"

<table>
<thead>
<tr>
<th>Yes</th>
<th>64%</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>36%</td>
</tr>
</tbody>
</table>

"or do you prefer to go out on an open tender basis (yes/no)?"

<table>
<thead>
<tr>
<th>Yes</th>
<th>30%</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>70%</td>
</tr>
</tbody>
</table>

With 64% in favour of a negotiated contract with a contractor of their own choice and against going out on an open tender basis one may conclude that it is most desirable to enter a negotiated contract with a contractor of your own choice. This would indicate
Question 14

"Would you find it acceptable for a developer to have an architect prepare working drawings, and then for the developer himself to manage the building and construction work on a development project?"

As with question 13, a split of 49% for and 51% against it being acceptable for a developer to arrange for an architect to prepare working drawings and then for the developer himself to manage the building and construction work on a development project, is indecisive and the issue needs to be agreed and clearly recorded in a clause in the development agreement.
"32.4. do you fix the operating costs at a prescribed amount escalating at a prescribed rate - (yes/no)?"

The preponderance of affirmative answers to this question shows that gross masses are still alive and well and favoured by the property industry.
"32.3. to whom do you allocate responsibility for selecting maintenance operators for functions such as security, cleaning, gardening, lift and escalator maintenance etc. when negotiating the terms of a development agreement—(developer or investor/buyer)?"

The market has unequivocally indicated that it is the right of the investor/buyer to select the maintenance operators for a particular property.
"32.2, do you define in detail each specific operating cost item which will be deducted from the gross income and wait for the actual costs to be incurred before calculating the net income figure - (yes/no)?"

The response to this question was fairly evenly divided with similar numbers of respondents using and not using this method to achieve certainty in establishing the net return from the property.
Question 32

"When providing for the calculation of a "net return" required in terms of a rental guarantee or headlease,

32.1. do you specifically distinguish between and define those items that constitute capital costs and those that constitute income expenditure to be incurred in the maintenance of the buildings - (yes/no)?"

As may be seen in the chart above, the sample population is emphatic that it does specifically distinguish between capital and income expenditure items although in my own experience this is seldom the case.
Question 31

"Also, if your answer to question 26 above is yes, when calculating a provision for letting commissions to be paid after the scheme has been handed over and the developer has been paid out his final draw what sort of duration would you use for the rental lease forming the basis of the commission estimate - (1 year, 3 years, 5 years or other period)?"

Five years is the most popular period followed by the three and one year periods respectively. Given the favour shown to the longer duration and consequent greater sums of money which will be retained, the role of the development agreement in clarifying this issue of letting commissions and in establishing the criteria for how payments are to be made becomes even more important.
"If your answer to 29 above is yes, when calculating the retention for tenant fitting out costs where the tenant might only take occupation some time after the scheme has been handed over to the purchaser, do you use - the current cost estimate as calculated by the project quantity surveyor plus any interest earned on that amount until it is drawn down, or the current cost estimate plus a building cost escalation factor plus any interest earned, or another method?"

The respondents were fairly evenly divided between the first two alternatives slightly favouring the current cost plus interest only option. The other method mentioned by two respondents was the current cost estimate plus a building cost escalation only i.e. with no interest accruing.
Question 29

"When negotiating the purchase or sale of a development, do you make provision, in the project price, for first time, once off tenant fitting out costs and letting commissions where the tenants might only take occupation after the scheme has been handed over by the developer to the investor (yes/no)?"

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>5%</td>
</tr>
<tr>
<td>Yes</td>
<td>95%</td>
</tr>
</tbody>
</table>

The chart shows overwhelming support (95%) for making such a provision in the project price.
**Question 28**

"Where a retention is held by the purchaser/investor against performance by a vendor/developer, do you believe the money should be held - (in trust, directly by the investor or in some other manner)?"

![Pie Chart]

As the pie chart shows the respondents were fairly evenly divided between holding cash retention monies in trust and directly by the investor. The other manner response was in "a high yielding interest bearing account with interest for the developer".
in order to calculate their likely return from a project more accurately.

The "other" response states that the rental guarantee retention "should be released against approved lettings" which would seem to infer that there is no outside time limit for expiry of the guarantee.

Question 27

"Where a retention is held against performance by a developer, by withholding part of the project price or part of the development profit, would you usually negotiate for the retention to be held - (in cash/by bank guarantee)?"

With 65% favouring bank guarantees this is another document to be included with the development agreement.
Question 26

"Where a rental guarantee is utilised to secure an initial return for an investor, for what duration do you believe it fair and reasonable to secure the initial return assuming that the building is let gradually and assuming that the retention amount, as calculated in question 25 above, is not entirely consumed within that initial period?"

<table>
<thead>
<tr>
<th>Duration</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 months</td>
<td>50%</td>
</tr>
<tr>
<td>12 months</td>
<td>30%</td>
</tr>
<tr>
<td>18 months</td>
<td>10%</td>
</tr>
<tr>
<td>24 months</td>
<td>9%</td>
</tr>
<tr>
<td>30 months</td>
<td>5%</td>
</tr>
<tr>
<td>&gt;3 yrs</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>0%</td>
</tr>
</tbody>
</table>

Again, the chart demonstrates the sample population's strong support for the 12 month period. In other words the most popular form of rental guarantee comprises one year's rental tied up for one year. When one year has elapsed after the hand over date, the developer would be entitled to receive any guarantee amount remaining and would have no further financial rental commitment to the investor.

At 29% of the response it appears that it is fairly common for the one year's rental to be locked up for a period of 24 months before release to the developer and at 11% there are instances where it is even locked up for 36 months.

This points to a regular transfer of the initial letting risk in property development projects from the investor to the developer. Developers thus need to factor this risk into their feasibility studies.
Question 25

"When using a rental guarantee to secure an initial return for an investor, what is the usual amount of rent you would seek to retain (expressed in months)?"

The most popular guarantee commitment sought from developers is 12 months rent as is evident from the chart above. With 12% of the vote each, the 6 month and 24 month periods obviously also find fairly regular application.

The "other" statistic refers to a statement by one of the respondents (a construction company acting as developer) that it does not offer rental guarantees, but instead signs headleases which run from 10 to 20 years.
Question 24

"What documents do you or would you typically include in a development agreement as annexures?"

A 21% and 20% response in favour of the annexure of design documents and building documents respectively provides evidence of the fact that design documents and building specifications are the most frequently included annexures to development agreements. At 18% of the sample, land sale agreements are the next most important inclusions followed by specimen leases, building contracts and contracts with consultants.

Other documents mentioned as being typically attached to development agreements include: zoning or rezoning certificates, copies of title deeds, the financial feasibility study with a schedule of anticipated rentals and operating costs, proof of insurance, a bill of quantities and any other costing information, a statement of the method of measurement of rentable space, bank guarantees from the investor, performance guarantees, tenant layouts, indicative tenant mix schedule and letters of intent from major tenants, an interest calculation clause and a schedule setting out the rental guarantee calculation.
5.3. Recommendations for further study:

Bearing in mind that this is an initial work on the subject it would be useful to:

- look at a comparison of some further existing agreements;
- possibly identify specific types of agreement appropriate to specific types of development;
- attempt to formulate a definitive set of ancillary agreements to be appended to property development agreements;
- further refine the checklist proposed above;
- investigate the reported case law which exists where disputes have arisen out of the development process or over the terms of a development agreement.
Defect list and rectification procedures

Insurance

Statement of who bears the risk of any damage to or delay in the project and the time, date and stage of completion necessary to be reached for hand over of that risk to occur

6.2.6. Letting

- Copy of standard lease document
- Tenant selection criteria and responsibility
- Indicative tenant mix schedule
- Letters of intent from major tenants
- Tenant installation procedures
- Appointment of letting agent
- Cession of the right to collect rental directly from tenants in terms of a headlease or rental guarantee
- Provision for tenant installation allowances and letting commissions where the letting of buildings takes longer than the rental guarantee period

5.2.7. Management and ownership

- Responsibility for compliance of building with local municipal regulations
- Indication of who owns any retention held against the developer
- Clause allowing investor to pay contractor directly where necessary
- Guarantee by developer and method of interest calculation
- Definition of initial return comprising the guarantee and the accounting method to be used in its calculation
- Bank guarantees from the investor
- Provision for tenant installation costs and letting commissions
- Provision for final measurement of the building and adjustment of the purchase price
- Description of what comprises operating costs in defining the net return to be generated by the investment

5.2.5. Construction

- Provision for the employment of a "watching brief" quantity surveyor
- Inspection rights
- Copy of the building contract
- Responsibility for cost escalations
- Waiver of builder's lien
• Confirmation of brief to and responsibilities of the various professionals

• Copy of contracts with consultants

• Determination of what comprises the design documentation and a description of the deviation procedure

• Copies of design documentation and building specifications

• Breakdown of development costs as estimated by project quantity surveyor

• Method of measurement of the building areas

5.2.4. Financing

• Description of the items making up the total cost of the scheme

• Copy of feasibility study with schedule of expected rentals and operating costs

• Details of how payment is to be made by investor to developer

• Security for obligations of developer (i.e. retentions and cession of any performance bonds and the like provided by sub-contractors)

• Copies of performance guarantees
* land
* letting period
* maintenance period
* net rental
* sale agreement
* total development costs
* Description of the project/development and the end product envisaged
* Developer's duties and the timing of completion of those duties
* Indemnification of investor or investor's company by the developer

5.2.2. Land acquisition

* Description of the land
* Copy of land sale agreement
* Copy of zoning certificates
* Copies of title deeds
* Conditions precedent
  * Zoning/land use rights
  * Necessary consents and permissions
  * Ownership of or option over the land to be developed
  * Extent of the site and location of boundaries

5.2.3. Design, cost and consent

* Selection of professional team
Flowing from the conclusions drawn above it is apparent to me that property development agreements need to be flexible in order to accommodate the different requirements of the signatories and must be adaptable to the circumstances of each particular transaction, therefore a single pro-forma example of the agreement would not be of much use to the industry, however a checklist itemising those factors which could cause uncertainty in a property development transaction should be of some use.

5.2. Checklist for use in drafting property development agreements

This checklist will deal only with those items regarded as "essential" to the agreement and will not cover the standard clauses which are typically appended to development agreements.

The list is set out in point form and is intended to assist parties who wish to draft development agreements by acting as an "aide memoir" with regard to the more important concepts.

5.2.1. Concept feasibility

- Definitions
  - building
  - building documents
  - ceiling cost
  - commencement date
  - completion date
  - defect list
  - developer
  - development
  - development profit
  - effective date
  - final completion certificate
  - initial return
  - intended completion date
  - investor/investor's company
10. Construction risk (e.g. works risk, delay labour action, weather, materials shortages etc.)

10. Unforeseen building cost escalations

After evaluating the risks managed by a sample development agreement (pages 49 to 85 above), and observing from my own experience that this is a fairly representative form of property development agreement, I conclude that existing forms of the property development agreement are effective and that they serve a useful purpose in creating certainty as to who will bear what risks (including, but not limited to those listed above) in the process and in establishing a procedure for dealing with disagreements arising out of the transaction (Para 14 mentioned on page 50 which is the arbitration/dispute resolution clause in the sample agreement).

Some parties will be better served by one particular version of the agreement than others and the usefulness of the agreement to the various signatories is dependent upon their relative positions of strength when negotiating the terms of such agreements.

Existing agreements do have a number of shortcomings (discussed on pages 92 and 93 above) and there are always issues which they fail to address. These issues may be different for the various forms of the agreement and will be influenced by the particular circumstances of the signatories to each particular agreement.

From this, one may conclude that no one agreement is perfect and there will always be various discrepancies and omissions because, inter alia, the agreements often have to be negotiated drawn up and signed quickly in order to facilitate the transaction, the weaker party to the transaction may be obliged to omit some protective clause in order to ensure the progress of the project, the parties may be inexperienced in the drafting of such contracts and some of the information necessary to draft the agreement effectively (e.g. castings data) may not be available in time for the negotiation.
1. Concept/feasibility
2. Land acquisition
3. Design, cost and consent
4. Financing
5. Construction
6. Letting
7. Management and ownership

and that because there are many risks applicable to all of the above stages of the property development process, as set out and discussed in pages 35 to 40 of this report, the property development agreement needs to cover aspects of all of these stages to be fully effective.

There are specific risks applicable to each stage and the ten most serious risks, in order of importance, have been identified by market research (Question 9 of the questionnaire), as being:

1. The timing of the scheme within the property and economic cycles
2. Securing the appropriate or desired rights for the site
3. Finding a buyer or investor for the scheme
4. Achieving budgeted rentals
5. Letting proceeding more slowly than anticipated
6. Inappropriateness of the building design
7. Inaccuracy of estimation of the end value of the scheme
8. Poor quality construction and project supervision
9. Finding bridging finance to proceed with the scheme whilst looking for long term finance or an investor
Chapter 5
Conclusion

5.1. Summary of conclusions

The market research conducted for and forming part of this study confirms firstly that the property development agreement does exist. Question 4 in the questionnaire sought to establish the nature of the parties to a property development agreement and given that there was a 100% response to the question, and that 92% of the respondents indicated that the property development agreement was concluded between the investor and the developer, it would seem logical to deduce that the sample agrees that the property development agreement does exist.

Secondly, in the light of the response to Question 7 in the questionnaire in which 100% of the respondents indicated their belief that a written development agreement is "absolutely essential" in managing risks inherent in the property development process, I believe it to be reasonable to conclude that there is a need for the property development agreement.

Thirdly, the 93% response of "always" to Question 8 in the questionnaire in which the sample was asked whether a written property development agreement was concluded "always" or "sometimes" (with the approximate % of times), indicates that the property development agreement is used regularly by the industry and specifically by property developers, property investors and managers (Question 1 in the questionnaire), who are mainly involved in commercial (offices) 33%, retail 30%, and industrial 26%, property business (Question 2 of the questionnaire), and where the property development schemes are mostly in the R5 million to R20 million range (Question 3 in the questionnaire).

As set out in pages 10 to 48 of this report, I conclude that the property development process can be broken down into several distinct stages namely:
Varied responses to the suggested methods of calculation of the "net return" expected from a property also indicates a need for the development agreement to make the risk allocation more certain.

Overall, the development agreement appears to be an important, useful document in the management of risk in the property development process and its form needs to be flexible enough to accommodate the various circumstances of each development transaction.
4.3. Conclusion

The relevant segment of the property market is fully aware of the existence of the development agreement and uses it extensively. It correctly understands the agreement to be between the investor and developer and believes the investor to be the main beneficiary from its conclusion.

The key risks identified and set out in the preceding pages generally appear able to be managed by the negotiation of a development agreement which assists in creating certainty regarding the allocation of those risks and responsibilities amongst the various parties to the agreement, particularly between the investor and developer.

The divergent opinions expressed over how development risks should be managed and who should bear them expose a clear need for a written agreement to be drafted for every sizeable property development project. This need is confirmed by the sample population's observations that the most cost effective method of ensuring performance in such a project is through a process of negotiation and agreement.

A number of suggestions were received with regard to the documentation which should accompany a development agreement and my conclusion here is that the market would like the agreement to be as precise as possible and that as many measures as are necessary to achieve the desired level of clarity should be included with the agreement.

The rental guarantee emerged as the most favoured technique employed to secure the financial return from a property investment and a one year rental secured for one year is its most prevalent form.
Question 33

"What rate do you use to calculate the notional return payable by a developer during the construction phase of a development project as the funds are being drawn down and before any tenants have begun paying rental - (a property related return, the long bond rate, a money market or 3 month NCD rate or some other rate)?"

The bulk of the sample population uses a property related return with very few employing the other rates suggested in the question. Additional rates identified as being used included the prime bank rate and a combination of the property return and the long bond rate.
Appendix 1.

payable in terms of this agreement to BUILDING COMPANY (PROPRIETARY) LIMITED as security for its obligations in terms of the building contract;

3.3.14. procure that the development is carried out and that the land is landscaped and the buildings are built in accordance with the design documents, that all materials used in the construction of the buildings are substantially in accordance with the design documents and that a standard of workmanship and finishes is maintained as is specified and/or contemplated therein and in the event that this agreement and/or the design documents fail short or omit any matter necessary for the completion of the development, then it shall be done in accordance with sound building practice utilised in A grade good quality office buildings in the decentralised office areas of (the location of the development) insofar as quality and quantity is concerned and the developer shall do all that is necessary and make all the necessary provision for the due and proper completion of the development;

3.3.15. make good or cause to be made good-

3.3.15.1. any defects, shrinkages or other faults and shortcomings which
Appendix 1.

will be in accordance with the design documents, including the specifications of the engineer;

3.3.10. ensure that the development will be in accordance with the township conditions of the land;

3.3.11. ensure that the development is completed by no later than the intended completion date; provided that if construction of the building is delayed by via major or by reason of any exceptionally inclement weather or by reason of civil commotion, local combination of workmen, strike or lockout or delayed by any other causes beyond the control of the developer and which it could not have foreseen at the signing of this agreement and which the architect considers sufficient, in which case the architect shall certify a fair and reasonable extension of time for the completion of the buildings;

3.3.12. procure that the contractors and subcontractors agree to the terms and conditions of this agreement and comply with the provisions thereof;

3.3.13. enter into a written standard form building contract with BUILDING COMPANY (PROPRIETARY) LIMITED and shall ensure that it holds retention money of not less than 5% of the total amount

Page/..... 10
Appendix 1.

the erection and completion of the buildings (by the local and other competent authorities);

3.3.7. pay all fees and other charges (including water, sewerage and the electricity connection charges) payable to the (name of local authority) or to any other competent authority in connection with the submission and approval of plans for the development and the provision of public utility services to the buildings and to the land and also to pay any development contribution which may become payable as a result of any change in the relevant Town Planning Scheme;

3.3.8. procure that proper provision is made for the support and use of any walls, buildings, roads or foot paths, situated in the whole or in part on adjoining properties or streets and that, in carrying out the building operations, all reasonable measures and precautions are taken and observed to prevent any avoidable nuisance in or on the land, or anything which may cause annoyance, inconvenience or disturbance to the owners, tenants or occupiers of adjoining property;

3.3.9 ensure that all the necessary soil investigations have been done and that the building foundations
Appendix 1.

3.3. The developer shall -

3.3.1. endeavour to commence with the development on the commencement date;

3.3.2. supervise the activities of all consultants and contractors appointed to the development;

3.3.3. effect such insurances as the company through such brokers may reasonably require or approve, including, but not limited to those referred to in clause 18.;

3.3.4. supervise and co-ordinate payments to consultants and contractors against appropriate progress of construction and certification thereof by the architect and shall ensure that payments are not made in advance of due date and that normal retentions are effected;

3.3.5. allow the company at the company's election to attend meetings with it and with the consultants from time to time;

3.3.6. procure the approval of the design documents, all consents and town planning and zoning provisions which are required for the purpose of
Appendix 1.

2.2. The parties undertake to use their best endeavours to procure the timeous fulfilment of the conditions referred to in clause 2.1.1. and 2.1.3.

2.3. Should all the conditions not have been fulfilled by the date contemplated by clause 2.1. then this agreement shall ipso facto lapse and the status quo ante shall be restored and neither party shall have any claim against the other arising pursuant thereto, save as set out in clause 25.

3. THE DEVELOPMENT

3.1. The company requires and authorises the developer (as it hereby does) to develop the land as set out in the building documents and to erect the buildings thereon in accordance with the building documents with effect from the effective date. It is recorded that the building shall consist of approximately \( X \) square metres of lettable office space and \( X \) square metres of lettable warehouse space which may be varied in terms of this agreement but subject to the limits set out in clause 1.1.1.

3.2. The developer undertakes to employ consultants, contractors and sub-contractors so as to cause the development to be effected timeously and completed in terms hereof and at the developer's expense against payment from time to time, as hereinafter provider, by the company of amounts in respect of items making up the total development cost but limited to the ceiling cost.
Appendix 1.

shall be given to it as if it were a substantive provision in the body of the agreement.

1.5. In this agreement, unless the context clearly otherwise requires, all measurements of the buildings are on the BOMAI standard.

1.6. For the purposes of this agreement, unless the context otherwise clearly indicates, all references to "writing" includes telex and telefax.

2. CONDITION PRECEDENT

2.1. This entire agreement is subject to the fulfilment of the undermentioned conditions precedent by not later than (day, month, year) or by such extended date as the parties may agree to in writing and in the exercise of their absolute discretion:

2.1.1. the conclusion and becoming unconditional of the vendor's agreement;

2.1.2. the readiness of the land to enable the company to erect the buildings thereon; and

2.1.3. the registration of the transfer of the land into the company's name.
Appendix 1.

respect of basement storage space RX per square metre;

1.1.23. "LETTING AGENT" means LETTING AGENT (PROPRIETARY) LIMITED;

1.1.24. "total development costs" means the costs to be incurred in respect of the development as listed in clause 7;

1.1.25. "INVESTOR" means INVESTOR (PROPRIETARY) LIMITED;

1.1.26. "vendor's agreement" means the agreement between the INVESTOR and the (full names of property sellers) for the purchase of the entire issued share capital of the company;

1.2. Clause headings where used in this agreement are used for convenience and shall not be referred to in the interpretation of this agreement.

1.3. Any reference to an enactment is to that enactment as at the date of signature hereof and as amended or re-enacted from time to time.

1.4. If any provision in a definition is a substantive provision conferring rights or imposing obligations on any party, notwithstanding that it is only in the definition clause, affect...
Appendix 1.

1.1.17. "initial return" means an income to the company during the letting period in the form of the net rentals which for the first 12 months of the letting period shall be equal to the net rentals set out in clause 1.1.22, multiplied by the final measurement of office space and parking bays and escalated at 12% compounded annually for the second and third 12 month periods of the letting period respectively;

1.1.18. "Intended completion date" means (day, month, year);

1.1.19. "land" means Stand X, District X, Registration Division X, Province X, measuring X square metres;

1.1.20. "letting period" means the period of 36 calendar months commencing on the completion date;

1.1.21. "maintenance period" means the period of 90 days commencing on the completion date;

1.1.22. "net rental" means in respect of office space RX per square metre, in respect of warehouse space RX per square metre, in respect of covered parking bays RX per parking bay, in respect of open parking bays RX per parking bay and in
Appendix 1.

1.1.10. "developer" means DEVELOPER (PROPRIETARY) LIMITED;

1.1.11. "development" means the land, the preparation thereof and the buildings and the construction thereof;

1.1.12. "development profit" means the development profit payable in terms of clause 7.2.2.;

1.1.13. "effective date" means the date on which this agreement is signed by all the parties;

1.1.14. "final completion certificate" means a certificate issued by the architect to the company and the developer in which the architect certifies that all defects as listed in the defect list have been rectified;

1.1.15. "final measurement" means the measurements of the total rentable space and number of parking bays in accordance with clause 1.5. as certified by the architect;

1.1.16. "initial design documents" means those documents initially to be supplied by the developer, listed in Annexure A hereto;
Appendix 1.

1.1.3. "ceiling cost" means the amount of RX ($X in words) which amount may be varied in accordance with the formulae set out in Annexure C, depending on the variance in the office space and/or parking bays in accordance with the final measurement;

1.1.4. "commencement date" means (day, month, year);

1.1.5. "company" means INVESTOR COMPANY (PROPRIETARY) LIMITED;

1.1.6. "completion date" means the first day of the month succeeding the month during which the buildings shall have been completed as certified by the architect which shall be when the buildings have been completed in accordance with the final building documents and are complete for tenant occupation;

1.1.7. "conditions precedent" means the conditions precedent referred to in clause 2.1.;

1.1.8. "day" means a working day excluding Saturdays, Sundays and public holidays;

1.1.9. "defect list" means the list of defects as set out in clause 16.;
WHEREBY IT IS AGREED AS FOLLOWS:

1. DEFINITIONS AND INTERPRETATIONS

1.1. In this agreement, unless inconsistent with the context, the following expressions or terms shall have the meanings ascribed to them respectively:

1.1.1. "building" means a building consisting of a maximum lettable area of $X$ square metres of which the office area shall not be less than $X$ square metres nor more than $X$ square metres, the remaining lettable area shall consist of warehouse space, with $X$ covered parking bays and $X$ open parking bays, to be erected on the land in accordance with the design documents, provided that notwithstanding the aforesaid, the building shall have as many parking bays as are required by municipal regulations having regard to the tenant mix of the building;

1.1.2. "building documents" means the approved plans and specifications, the finishing schedule, the electrical specification, the plumbing specification, the landscaping specification, the civil engineering specification and the building and other sub contracts, listed in Annexures A and B hereto, and to be annexed hereto;
Appendix 1.

SAMPLE DEVELOPMENT AGREEMENT

entered into between

INVESTOR COMPANY (PROPRIETARY) LIMITED

(Registration No.................)

and

DEVELOPER (PROPRIETARY) LIMITED

(Registration No..................)
Appendix 1.

approved by the developer and the INVEStOR;

8.3.2.2. is a lease for a minimum period of three years which complies with this clause 8.3. and with at least the following terms and conditions:

8.3.2.2.1. the commencing rental in respect of the office space, covered parking bays and open parking space and showroom space, if applicable, shall not be less than the net rentals set out in clause 1.1.22.;

8.3.2.2.2. the tenant pays pro rata for all costs and maintenance as more fully set out in Annexure D;

8.3.2.2.3. the rental payable by the tenant, including parking, escalates at least 12% per annum, compounded from the date of the lease's commencement;
Appendix 1.

8.1. It is recorded that the developer has appointed LETTING AGENT No. 1, and LETTING AGENT No. 2, as joint sole letting agents for the letting of the buildings ("the agents").

8.2. The maximum letting commission payable to the above agents for the letting of all lettable area shall be RX (X in words) in total, which shall be paid by the developer.

8.3. Prior to and for the duration of the letting period-

8.3.1. no lease shall be regarded as approved save with the prior written approval of the company which approval shall not be unreasonably withheld, provided such lease complies with the provisions of clause 8.3.2.;

8.3.2. a lease in respect of which the company's consent shall not be unreasonably withheld in terms of clause 8.3.1., shall be one which-

8.3.2.1. is negotiated by the agents appointed in terms of clause 8.1. and which, although it does not comply with this clause 8.3., the company has in writing agreed to accept and approve whether conditionally or otherwise, provided that the financial standing of the tenant has been...
amount from the developer immediately after the liability therefor has arisen, irrespective of whether the company had already paid the amount or not. Any certificate given under the hand of a director of the company indicating the amount of any such excess shall constitute prima facie proof in any court of law of the correctness of such amount and the liability of the developer to pay it such amount.

7.4. The developer shall submit monthly statements of development costs incurred in the execution of the development accompanied by its relevant supporting documentation and invoices to the company, duly certified by the architect as being true and correct, and the company shall, provided this does not exceed the ceiling cost, subject to clauses 9. and 10., pay to the developer the amount so specified within 7 days of receipt who shall in turn pay to the recipients entitled thereto, the amounts due in respect of the items making up the total development costs. Such payments shall be regulated and scheduled so as to reduce the number of payments to a reasonable minimum.

7.5. The developer shall deposit RX (X in words) with the INVESTOR, upon it receiving its first payment as envisaged by clause 7.4., and the provisions of clauses 9. and 10. shall apply mutatis mutandis to this amount.

8. APPOINTMENT OF LETTING AGENT
Appendix 1.

with premises in the building not recovered from tenants) of premises leased in the buildings which is payable prior to the completion date; and

7.1.3.13. the proceeds of any insurance received in respect of a delay in the project pursuant to clause 7.1.3.5. above.

7.2. The developer warrants in favour of the company that the total development cost will not exceed the ceiling cost. Consequently, should the total development cost -

7.2.1. be more than the ceiling cost, then the developer shall bear and pay any such excess to whomsoever it may be due and the developer hereby indemnifies the company against any loss or claim in this regard; and

7.2.2. be less than the ceiling cost, then such difference shall be the development profit and shall be payable on the completion date to the developer, subject to clause 9.

7.3. Should the company be liable to any third party in respect of any amount forming part of such excess referred to in clause 7.2., then the company shall be entitled to recover such
Appendix 1.

7.1.3.6. all letting commission payable in respect of first lettings during the letting period;

7.1.3.7. the placement fee and commission payable to the LETTING AGENT in respect of the development;

7.1.3.8. any and all other items reasonably necessary for the completion of the development and the letting of the building;

7.1.3.9. the cost of all fixtures, fittings and equipment installed in the building;

7.1.3.10. the tenant installation costs and prime cost items, subject to the quantities and amounts specified in the design documents;

7.1.3.11. the amounts payable in terms of clause 7.5. below;

from which the following shall be deducted -

7.1.3.12. the net income (i.e. gross rentals receivable by the company less all expenses and charges in connection with the letting of the development)
Appendix 1.

7.1.3.2. all payments due to the contractor/s and subcontractor/s and the local authority and Inland Revenue;

7.1.3.3. notional interest on all amounts disbursed from time to time by the company, including but not limited to all items referred to in this clause 7.1. as part of the total development costs, such notional interest to be reckoned and calculated at 12% per annum, capitalised monthly in arrears, from the date of each disbursement until the completion date, subject to clause 7.3.;

7.1.3.4. all legal costs and stamp duty and VAT;

7.1.3.5. all insurance premiums relating to the carrying on and completion of the development; the policies of insurance which will cover the respective interests of the parties as is more fully set out in clause 18 below.
Appendix 1.

6.6. Save as set out in this clause, the building documents may not be altered unless otherwise requested and agreed between the company and the developer in writing.

7. **TOTAL DEVELOPMENT COSTS**

7.1. The total development costs shall mean all costs, charges and notional interest in connection with the development and without derogating from the generality of the foregoing this shall include -

7.1.1. the total purchase price payable by the purchaser in terms of the vendor's agreement for the shares in or claims against the company including the cost of the land, if not yet registered in the name of the company;

7.1.2. all costs attributable to the payment of betterment;

7.1.3. the costs of the development, whether paid or not, including -

7.1.3.1. all fees and disbursements in connection therewith of architects, engineers, quantity surveyors, attorneys and other professionals as the developer or the company may reasonably appoint from time to time;

Page/..... 17
Appendix 1.

written approval of the company, which approval will not be withheld unreasonably. Should there be any need, in the opinion of the developer, for any material deviation from the building documents, it shall then furnish full particulars to the company.

6.4. Within 7 days after receipt of particulars of any deviations the company shall in writing, inform the developer whether or not it approves of the deviations. Provided the company has received such particulars, the company shall be deemed to have approved of the deviations, if it does not in writing within the said period of 7 days otherwise inform the developer. If the company requires any amendment and/or alterations to any deviations, they shall inform the developer thereof within a period of 7 days. The parties will then use their best endeavours to reach agreement thereon, as a matter of urgency.

6.5. Any agreement or any deviation shall be recorded in a memorandum signed by the company and the developer, and shall be annexed to the building documents, and shall be deemed to be incorporated in and to form part of the building documents. Save insofar as may be stated specifically in such written amendment or addition, no amendment or addition shall affect the ceiling cost to be paid to the developer.
Appendix 1.

5.1.4. all amounts retained by the developer as retention monies against the main building contractor and/or any subcontractor and/or any member of the professional team;

and monies paid to the developer in terms of its rights listed above, shall forthwith be paid to the company upon receipt thereof by the developer.

5.2. The developer shall ensure that all the builders' liens are waived by the builders, contractors and sub-contractors.

6. DESIGN DOCUMENTS AND DEVIATION PROCEDURE

6.1. The developer shall procure the preparation of the:

6.1.1. initial design documents which shall be annexed to this agreement; and

6.1.2. the final building documents, as specified by the company, which shall consist of at least the documents listed in Annexure B hereto, on or before (day, month, year);

6.2. Once the design documents have been prepared they shall be submitted to the company for its written approval which approval shall not be unreasonably withheld.

6.3. The developer undertakes that there will be no material deviations from the building documents without the prior

Page...... 15
Appendix 1.

4.7. The developer warrants that all persons appointed to be engaged with the development shall be duly qualified for what they are appointed to do.

5. SECURITY BY THE DEVELOPER

5.1. As security for due compliance by the developer of all its obligations of whatsoever nature in terms of this agreement, the developer hereby cedes to the company all its rights to the following:

5.1.1. the performance guarantees or bonds furnished or to be furnished by all contractors in respect of the construction of the buildings provided that all such performance guarantees or bonds are approved of by the company in writing, which approval will not be withheld unreasonably; and

5.1.2. the right to receive from and/or retain against the building contractor and/or any other contractor and/or the professional consultant, damages or penalties for late completion, or in respect of any other cause whatsoever; and

5.1.3. the benefits to the developer under any and all insurance policies taken out pursuant to this agreement and/or in respect of any aspect of the development; and
Appendix 1.

4.3. The developer agrees that while all professional and other parties to the development will be appointed and employed by it, the architect shall acknowledge in writing that he acts throughout on behalf of the company and the company shall accordingly be able and entitled to consult with him freely at all times.

4.4. The developer shall obtain from each of the professional consultants referred to in clause 4.1. an undertaking that in executing their functions they shall be under a duty of care to the company and shall be liable to the company for the performance of all their functions in a workmanlike and proper manner.

4.5. Without derogating from the provisions of clause 24., no member of the professional team, or a contractor, subcontractor, agent or employee of the developer will be or will be deemed to be a nominated subcontractor of the company and there will be no privity of contract between the company and any member of the professional team, contractor or subcontractor employed in connection with the development.

4.6. The developer shall disclose to the company all details of appointments referred to in clause 4.1. and of any termination of such appointments and of the appointment of any professional consultants, contractors or subcontractors in the place of those whose services it has elected to terminate.
Appendix 1.

appear in the development within the maintenance period;

3.3.15.2. any water leakages occurring in the development within 12 months after the first heavy rainfall occurring after the completion date;

3.3.15.3. any latent or structural defects which occur or are evident in the development at any time within a period of 3 years after the completion date;

4. PROFESSIONAL TEAM

4.1. It is recorded that the following professional team of consultants has been initially approved by both parties, but not yet formally appointed by the developer, viz -

4.1.1. architect -
4.1.2. structural engineer -
4.1.3. electrical engineer -
4.1.4. mechanical engineer -
4.1.5. quantity surveyor -

4.2. Any changes in the professional team shall be agreed by the developer and the company.
Appendix 1.

18.1.2. Public liability insurance (contract works) for a sum of not less than RX;

18.1.3. Public liability insurance (property owners' liability) for a sum of not less than RX;

18.1.4. Insurance against the loss that may arise upon the removal of lateral support and piling, if deemed necessary by the architect, and for such sum as specified by the architect.

18.2. The policies referred to in clause 18.1. above shall be on the terms and conditions normally contained in policies of the above nature, provided, however, that such policies shall at the request of the company be submitted to it for approval, which approval shall not be withheld unreasonably.

18.3. The developer shall pay all premiums and stamp duties in connection with the insurances effected by it, which shall form part of the development costs.

18.4. The developer shall be liable for the first amount payable in respect of each claim paid in terms of the policies effected by the developer, unless the event leading to such claim shall have arisen after the completion date.

18.5. The developer and/or the professional team and/or the building contractor and/or sub-contractor shall, where
Appendix 1.

All parties will hold in confidence and will not disclose or permit to be disclosed or communicated to any third person the contents of this agreement or any part thereof provided that it shall not preclude disclosure in the ordinary course of business.

18. INSURANCE

18.1. Without limiting the obligations, liabilities and responsibilities of the developer, the developer shall subject to clause 3.3.3. effect and maintain for the respective interest and rights of the developer, the company, the building contractor (including all other contractors, sub-contractors and suppliers on site, whether nominated or otherwise) and the professional team from the commencement date until the termination of the maintenance period, the following insurance:

18.1.1. Contract works insurance, which shall be for a sum of not less than the RX (X in words) plus 20% per annum calculated from the commencement date to cover escalation in building costs, demolition and professional fees and the contract works insurance policy shall be extended to cover physical loss or damage to the building arising from the perils and risks of "political riot and malicious damage" as insured by the South Africa Special Risks Association (SASRIA);
Appendix 1.

5.3. The architect may deliver to the developer additional lists of defects which are manifested in the development during the maintenance period.

15.4. The developer shall expeditiously and with the least possible inconvenience to occupants of the building rectify all the defects referred to above.

15.5. If the developer fails to rectify any defects which it has been notified of by way of a defect list, within the period of time which is reasonably necessary to effect such rectification after the defect came to its attention, then the company shall be entitled to give the developer written notice requiring it to rectify any such defect within a period of not less than 10 days and failing such rectification by the developer, the company shall be entitled to cause such defect to be rectified or to permit any tenant in the development to cause such defect to be rectified and to recover the reasonable costs thereof from the developer on written demand.

16. COMMISSION

It is recorded that the PLACING AGENT shall be paid a placement commission of Rx (X in words) by the developer within 7 days from the date on which the developer receives its first payment of the development cost, which placement commission shall form part of the development cost.

17. CONFIDENTIALITY
Appendix 1.

14.4. The arbitrator shall be entitled, without derogating from the generality of the foregoing -

14.4.1. to frame rules as to the conduct of the arbitration;

14.4.2. to make an order as to the costs thereof;

14.4.3. to have regard to equitability.

14.5. Notwithstanding any of the foregoing provisions, where any dispute or difference arises, the same shall first be referred to the attorneys for the parties. If they are not able within fourteen days of reference to them of such dispute or difference to resolve it, the preceding provisions may be invoked.

15. DEFECT LIST

15.1. The developer, the company and the architect shall inspect the development within 7 days of the completion date for the purpose of determining whether or not there are any defects in the development, and if there are any, to compile a list thereof.

15.2. The architect shall during the first 14 days of the maintenance period deliver to the company and the developer a defect list compiled by the architect, the developer and the company in respect of the development.
Appendix 1.

14. ARBITRATION

Should any question, dispute or difference arise as to the meaning and/or interpretation of the provisions of this agreement or relating to the mutual rights and obligations of any of the parties, then any such question, dispute or difference shall be submitted to and determined by arbitration in the following manner:

14.1. The arbitration shall be held informally, it being the intention that as far as possible the arbitration shall be completed within sixty days after it has been demanded.

14.2. The arbitration shall be conducted by -

14.2.1. If the matter in issue is an accounting matter only, an independent auditor agreed to by the parties and failing agreement, an auditor selected by the president for the time being of the Transvaal Society of Chartered Accountants;

14.2.2. If the matter in issue is anything other than an accounting matter or either of the parties disputes that it is an accounting matter, a practising senior counsel of not less than ten years' standing at the Johannesburg Bar, as agreed upon by the parties and failing agreement, as selected by the chairman for the time being of the Johannesburg Bar Council.

14.3. The decision of the arbitrator shall be final and binding upon the parties.
of or to suspect the existence of any act or circumstances contrary to or inconsistent with the terms hereof.

13. **INDEMNITY**

13.1. The developer shall be solely liable for and shall indemnify the company against and in respect of any liability, loss, claim or proceedings whatsoever arising under any statute or at common law, in respect of personal injury or damage to, or the death of any person whatsoever and injury and damage to any property whatsoever (including service or other damage to property or buildings not being on the site suffered by owners, tenants or other occupiers) which may arise at any time before the date when responsibility for the completion of the development has ceased or in consequence of any act of commission or omission on the part of the company or the developer, their agents, employees, servants, contractors, sub-contractors, professional consultants or any other person connected with it and arising out of, or in the course of, or by reason of the buildings, the construction and maintenance of the buildings and against all claims, demands, proceedings, damage, cost, charges and expenses whatsoever in respect thereof or in relation thereto.

13.2. The company shall not, without derogating from the generality of the provisions of clause 13.1. above, be liable for any damage that the developer may suffer as a result of any delay in the commencement of the development.
Appendix 1.

this agreement and the developer shall be obliged to rectify any such matter correctly pointed out by the company in the event of non-compliance. Should this result in any dispute between the developer and the company, such dispute shall be determined in accordance with the provisions of clause 14. hereof.

12.4. Nothing herein contained shall be construed so as to make the company or their representatives responsible for any part of the buildings or any defect whatsoever therein. The company shall not be responsible for any damage, loss or claims caused to any person, including the developer, for any delays in commencement of the development or construction, faulty materials, structural weakness or failure, errors in plans, specifications or bills of quantity, poor workmanship or errors in construction or non-performance by any person or howsoever occasioned in connection with any aspect of the buildings or the planning or execution thereof, including liability arising out of any actions of the developer or the company on or in connection with the land or the buildings before or after the signature of this agreement.

12.5. The company shall be entitled at all times to place full reliance on and exercise all its lawful rights arising from this agreement, notwithstanding the fact that it may have exercised or refrained from exercising, in whole or in part, its right of access and inspection in terms hereof, or any other right or act which might or could have led it to become aware
Appendix 1.

11.5. The company shall transfer from the deposit held pursuant to clause 9.1., and retain for its own account, or retain the amount under the bank guarantee or such portion thereof held pursuant to clause 9.2., whatever the case may be, such amounts from time to time as are required to meet the developer's guarantee in terms hereof.

12. INSPECTION RIGHTS

12.1. The company shall at all times be entitled to inspect the land, the buildings, the building documents and the books and records of the developer relevant to the development.

12.2. Without derogating from the generality of clause 12.1. above, the company shall be entitled at the developer's expense in terms of clause 7.1. to appoint one or more representatives of its choice to carry out a watching brief over the planning and execution of the development provided that the developer's expense in terms of this clause shall be limited to RX (X in words). The developer shall render all necessary assistance and co-operation to such representatives and, if and when so required by the company, the developer shall furnish it with copies of correspondence, minutes and other documents relating to the development of the land and buildings.

12.3. The company shall be entitled to draw to the attention of the developer to any aspects on which the company considers that the buildings are not being erected or the development is not being undertaken in accordance with the provisions of
Appendix 1.

11. TENANT INSTALLATIONS

11.1. Subject to clause 9., there may from time to time in the company's discretion as often as a lease is concluded in terms of clause 8. above be a release from the operation of clause 9. and be paid to the developer so much of the deposit referred to in clause 9.1. or there shall be a reduction in the bank guarantee referred to in clause 9.2., whatever the case may be, as is not required to provide for tenants' installations as certified by the architect pursuant to clause 11.3.

11.2. The prime cost items and provisional sums listed in the building documents shall be deemed to be allowances for tenants and the ceiling cost shall be reduced by the amount by which such amounts have not been utilised by tenants.

11.3. The architect shall on the completion date and thereafter on conclusion of any lease agreement prepare an estimate indicating the amounts reasonably necessary to attend to tenant installation in the building and any amounts remaining unpaid, whether by way of retentions or otherwise, to contractors, sub-contractors or professionals.

11.4. Where the cost to the developer of a tenant installation exceeds the cost allowance set out in the building documents, the developer shall be entitled to negotiate directly with the tenant to recover such additional costs from the tenant.
9.1.3. This deposit may, subject to clauses 9.3. and 10., be reduced on a pro rata basis, in the company's sole discretion, having regard to the leases that have been entered into with tenants during the letting period, as well as the lettable area which remains vacant during the letting period.

9.2. The developer shall, as an alternative to clause 9.1. be entitled to provide the company with a bank or other guarantee, as may be approved by the company and the INVESTOR in respect of the developer's liability in terms of this agreement, whereupon the company shall pro rata reimburse the developer the amount held in terms of clause 9.1. above. The company may in its sole discretion reduce the amount of the guarantee.

9.3. The provisions of clauses 9.1. and 9.2. shall apply mutatis mutandis in respect of the developer's obligations to complete the tenant installations and prime cost items.

10. THE INITIAL RETURN

The developer hereby undertakes and guarantees that the company will receive the initial return during the letting period and the developer hereby indemnifies the company against and will compensate the company for any loss or damages arising from a breach by the developer of the provisions hereof provided that the developer's liability in respect of the company's initial return shall be limited to the amount referred to in clause 9.1.
Appendix 1

8.3.2.2.6. on such other terms and conditions as set out in the standard lease used by the LETTING AGENT annexed hereto marked D.

9. GUARANTEE BY DEVELOPER

9.1. The company shall, subject to clause 9.2. either on the completion date or at such time when the total development cost is equal to 89 percent of the ceiling cost, as adjusted in terms of clauses 1.1.1. and 3.1., whichever occurs first, deposit in an interest bearing account with a registered building society and/or bank, as agreed with the developer (falling agreement the dispute to be resolved in terms of clause 14.) an amount equal to the total lettable area multiplied by the net rentals set out in clause 1.1.22. for the first 12 months of the letting period. The aforesaid deposit shall be deducted from the ceiling cost due to the developer, as security for the developer's obligations in terms of this agreement, for the duration of the letting period.

9.1.2. The developer shall be entitled to the accrued interest on the deposit, which interest shall be payable monthly in arrear, in a call account with the INVESTOR'S bank.

Page 25
Appendix 1.

8.3.2.2.4. the costs of and incidental to lease and stamp duty are payable by the tenant;

8.3.2.2.5. notwithstanding the provisions of clause 8.3.2.2, the rental payable by the tenant upon the termination date shall be adjusted so as to be equal to the market rental payable by tenants for similar premises which are situate in similar areas as that payable by tenants of the buildings; provided that the rental payable in respect of the first year after the termination of the letting period shall not be less than that paid during the last 12 months of the letting period escalated at 12% per annum; provided further that this provision shall only be applicable in respect of leases entered into at rentals less than that specified in clause 1.1.22.;
Dear Sir

RESEARCH REPORT QUESTIONNAIRE

This letter serves to formally introduce myself to you and to explain the reason for my request.

My name is Sandy Calder. I am currently in my final year of study (part-time) for an MSc (Building) degree in the specialised field of property development and management at the University of the Witwatersrand.

It is a requirement for partial fulfilment of the degree that I complete a research report. This I am doing under the supervision of Prof. R.I. Schloss and the object of the report is to assess the effectiveness of the development agreement as a tool for the management of risks inherent in the property development process.

This letter is accompanied by a questionnaire and I would be grateful if you would allocate some of your time to complete it and to return it to the University of the Witwatersrand Department of Building using the fax number stated above, within the next ten (10) days if possible.

If you wish your name or the name of your company to remain anonymous on the reply, that is fine as long as a description of the primary business of your company is given.

Analysis of the answers to the questions forms a significant part of the research for my report so a completed, returned questionnaire from you will be most valuable.
Appendix 1.

- where reasonably required by the company in accordance with sound engineering practice, maintenance and operating manuals in respect of all material and equipment installed in the building;

- detailed calculations of maximum and actual coverage used;

- a copy of the building plans, as approved by the local authority;

- guarantees (in favour of the company or, if not in favour of the company, then ceded to the company) in respect of all material and equipment installed in the building, provided that such guarantees can be reasonably obtained in terms of common building practice;

- complete maintenance manuals and maintenance agreements for mechanical, electrical and other installations forming part of the building, provided that such manuals and agreements can be reasonably obtained in terms of common building practice;

- further documents required by the company and which the developer consents to provide (which consent shall not be unreasonably withheld);

- the building contract and all contracts with subcontractors and consultants.
Appendix 1.

- all air-conditioning drawings.
- all landscape plans.

2. One paper copy of:
- door schedules, including ironmongery;
- window schedules, including burglar bars, glazing and details of coupling mullions and metal sections;
- internal finishing schedules;
- joinery details (excluding shop-fittings);
- parapet, canopy, gutter, wallbead and flushing details;
- consulting electrical engineer's drawings;
- (the drawings must incorporate all amendments, variations and alterations).

3. The following documents:
- a revised and up-to-date copy of the electrical specifications;
- a complete list containing the names of all contractors, subcontractors (nominated or otherwise), specialists, sign-writers and other firms employed;
APPENDIX "B"

FINAL BUILDING DOCUMENTS

1. One Sepia copy of the following "as built" plans and drawings:

- the site plan showing all applicable servitudes;
- the ground floor plan;
- all other floor levels;
- the roof plan;
- all sections;
- all elevations;
- all drainage drawings as built;
- all water reticulation system drawings as built;
- all stormwater disposal system drawings;
- all fire protection system drawings;
- all electrical lay-out drawings;
Appendix 1.

ANNEXURE A

INITIAL BUILDING DOCUMENTS

4 drawings
The BIFSA lump sum building contract
The building specifications
Appendix 1.

LIST OF ANNEXURES

A - Initial Building Documents
B - Design Documents
C - Ceiling Cost Formula
D - LETTING AGENT'S Standard Lease
E - Vendor's Agreement
Appendix 1.

SIGNED and WITNESSED by the parties on the following dates and at the following places respectively:

<table>
<thead>
<tr>
<th>DATE</th>
<th>PLACE</th>
<th>WITNESS</th>
<th>SIGNATURE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>For: DEVELOPER (PROPRIETARY) LIMITED</td>
</tr>
<tr>
<td>1.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td></td>
<td>who warrants that he is duly authorised hereeto</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DATE</th>
<th>PLACE</th>
<th>WITNESS</th>
<th>SIGNATURE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>For: INVESTOR COMPANY (PROPRIETARY) LIMITED</td>
</tr>
<tr>
<td>1.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td></td>
<td>who warrants that he is duly authorised hereeto</td>
</tr>
</tbody>
</table>
Appendix 1.

23. **WHOLE AGREEMENT**

This agreement constitutes the entire contract between the parties insofar as it relates to the development of the property and ancillary matters and no representations or warranties have been made or given save as set out herein. No amendment or consensual cancellation of this agreement or any provisions hereof and no extension of time, waiver or relaxation of any of the provisions of this agreement shall be binding on a party unless recorded in a written document signed by both parties.

24. **DEVELOPER NO AGENT**

It is recorded that the developer is not an agent or partner of the company and has no authority to act on behalf of or bind the credit of the company. The developer will not in any way give itself out as agent, partner or representative of the company.

25. **COSTS**

All the costs of and incidental to the drawing and preparation of this agreement and of giving effect thereto as well as the stamp duty hereon shall be borne and paid by the developer.
Appendix 1.

21.1.3. the developer:

21.2. Any notice required to be given by any party to the other in terms of this agreement, shall be in writing addressed to the party to whom it is to be given at the address of that party specified in clause 21.1. above, and shall be deemed (until the contrary is proved) to have been received by that party:

21.2.1. on the fifth day after the date of posting, if posted by prepaid registered post in the Republic of South Africa;

21.2.2. on the date of delivery if delivered by hand to such address and such delivery has been accepted in writing.

21.3. Each party to this agreement shall, on written notice to the other of the parties, be entitled to change its address referred to in clause 21.1. provided that such address is not a post office box or a poste restante.

22. DEFAULT AND CANCELLATION

If either party shall commit any material breach of the terms and conditions hereof and fail to rectify such breach within thirty days of written notice given to it by the other party so to do, then such other party shall be entitled, without prejudice to its other legal rights, including its right to claim damages, to cancel this agreement.
Appendix 1.

19.2. The developer shall procure that until the final completion certificate is issued by the architect that all the work is done in terms of this agreement and that such work is carried out with the minimum inconvenience to the tenants of the buildings including the rectification of all defects listed in the defect lists.

19.3. Within 30 days after the completion date, the developer shall deliver to the owner the building documents.

19.4. The architect shall issue the final completion certificate upon the termination of the maintenance period provided that all defects on the defect list have been rectified.

20. RESTRAINT ON CESSION

Neither party shall part with or cede or in any way dispose of any of its rights in terms of this agreement or any part thereof without the prior written approval of the other.

21. DOMICILIAM

21.1. For all purposes under this agreement or any amendment thereof in regard to any matter arising therefrom or in connection therewith, the parties choose domicilium sitandi et executandi at the following addresses:

21.1.1. the company:

21.1.2. the letting agent:
Appendix 1.

then the company may effect and keep in force any such insurance policy and pay such premium or premiums as may be necessary for that purpose and from time to time to deduct the amount payable by the company from any monies due or which may become due to the developer or to recover it from the developer.

18.7 In the event of physical destruction prior to the completion date, loss or damage to the building or any unfixed materials or goods, such physical destruction, loss or damage shall be the liability of the developer who shall make good such destruction, loss or damage and shall procure that the building contractor or any other party employed by the developer for this purpose, proceed with due diligence to remove or dispose of any debris, rebuild or restore the building, replace or repair the materials and goods, and proceed with the execution and completion of the building as provided for in this agreement. Such obligation shall exist notwithstanding the existence of any claim under any insurance policy and notwithstanding any delay in settling any insurance claim or any repudiation of an insurance claim.

19. **RISK AND HANDING OVER**

19.1. The developer shall hand over the development to the owner on the completion date from which date the risk in the development shall pass from the developer to the company.
Appendix 1.

applicable, provide as a minimum requirement the following insurances at their own expense:

18.5.1. Insurance of workmen in terms of the provisions of the Workmens' Compensation Act;

18.5.2. Employers, common law liability insurance with a limit of indemnity of not less than RX;

18.5.3. Insurance of construction plant and equipment and temporary structures (including their contents if not otherwise insured);

18.5.4. Motor vehicle liability insurance, comprising:

18.5.4.1. Insurance in accordance with the Compulsory Motor Vehicle Insurance Act, and

18.5.4.2. Balance of third party motor risks, including passenger liability.

These insurances shall be maintained in force until the termination of the maintenance period.

18.6. If the developer fails either itself or through the building contractor, sub-contractor or any member of the professional team to effect and keep in force the insurances referred to or to procure that the insurances are effected and kept in force,
Appendix 3.

- In cash
- by means of a bank guarantee

28. Where a retention is held by the purchaser/investor against performance by a vendor/developer, do you believe the money should be held:

- in trust
- directly by the investor
- in some other manner (please specify)

29. When negotiating the purchase or sale of a development, do you make provision, in the project price, for first time, once-off tenant fitting out costs and letting commissions where the tenants might only take occupation after the scheme has been handed over by the developer to the investor.

- yes
- no

30. If your answer to 29 above is yes, when calculating the retention for tenant fitting out costs where the tenant might only take occupation some time after the scheme has been handed over to the purchaser, do you use:

- the current cost estimate as calculated by the project quantity surveyor plus any interest earned on that amount until it is drawn down
- the current cost estimate plus a building cost escalation factor plus any interest earned
- another method (please specify)

31. Also, if your answer to question 29 above is yes, when calculating a provision for letting commissions to be paid after the scheme has
Appendix 3.

25. When using a rental guarantee to secure an initial return for an investor, what is the usual amount of rent you would seek to retain (expressed in months)?

- 6 months
- 12 months
- 18 months
- 24 months
- 36 months
- longer than 3 years
- other (please specify)

26. Where a rental guarantee is utilised to secure an initial return for an investor, for what duration do you believe it fair and reasonable to secure the initial return assuming that the building is let gradually and assuming that the retention amount, as calculated in question 25 above, is not entirely consumed within that initial period?

- 6 months
- 12 months
- 18 months
- 24 months
- 36 months
- longer than 3 years
- other (please specify)

27. Where retention is held against performance by a developer, by withholding part of the project price or part of the development profit, would you usually negotiate for the retention to be held:

Page/....10
Appendix 3.

- other (please specify)  

23. Following on from question 22 above, what do you believe to be the most cost effective method of ensuring performance in a property development project?:

- negotiation and agreement  
- cash flow manipulation  
- expert or arbitration procedure  
- litigation  
- other (please specify)  

24. What documents do you or would you typically include in a development agreement as annexures?:

- land sale agreement  
- building contract  
- contracts with consultants  
- design documents (drawings)  
- building specifications  
- specimen lease agreement  
- other (please specify)
Appendix 3.

construction or for any other reason, do you treat the retention as money which legally owned by the investor until such time as it is consumed in terms of the agreement or the agreed retention period has expired?:

- yes □
- no □

or do you treat the retention as part of the purchase price or part of a fee payable to the developer, and consequently legally owned by the developer, and then hold it in trust until it is consumed or until the expiry of the guarantee or retention period?:

- yes □
- no □

21. Which of the following forms of cover do you prefer to use to ensure performance and to secure the agreed return from a property development scheme?:

- rental guarantee □
- headlease □
- an agreement structured so that the developer is immediately put in breach, thereby giving rise to a claim for damages, if the agreed minimum return is not achieved □
- other form of retention (please specify) □

22. In your experience, how are the rights flowing from a property development transaction usually enforced during and after completion of the project?:

- by controlling the cash flow to the developer □
- arbitration procedure □
- litigation □
Appendix 3.

16. Once the contractor has been identified, do you prefer to enter into a contract based on a provisional contract price subject to remeasurement and valuation?:
   - yes [ ]
   - no [ ]

or do you prefer to enter into a fixed price lump sum tender (i.e. not subject to remeasurement)?:
   - yes [ ]
   - no [ ]

17. When negotiating the purchase or sale price of a property development project, do you provide for the lettable area of the building, on which the purchase price is based, to be measured on completion and for the purchase price to be adjusted accordingly?:
   - yes [ ]
   - no [ ]

18. Where you enter into a headlease do you ensure that it contains a clause cancelling any cession, from, the purchaser/head lessor to the developer/vendor/head lessee, of the property owner’s rights as landlord in respect of the tenants actually occupying the building?:
   - yes [ ]
   - no [ ]

19. When negotiating the terms of a development agreement, do you make provision for direct payment to be made to subcontractors by the investor where the developer runs into financial difficulties or for whatever reason fails to make any payment due to any of the subcontractors working on the development?:
   - yes [ ]
   - no [ ]

20. When negotiating the terms of a development agreement, in which a retention is agreed upon for purposes of a rental guarantee, future tenant installation costs, letting commission, completion of....
Appendix 3.

11. Do you believe it is necessary for the investor/financier to employ a "watching brief" quantity surveyor in addition to the project quantity surveyor to protect its interests?:
   - yes
   - no

12. Do you believe it is more beneficial for a developer to enter into a turnkey (package deal) contract with one contractor instead of entering into various separate contracts with individual professionals, consultants and contractors?:
   - yes
   - no

13. Do you believe that the full services of an architect, including supervision, should be retained in all development projects?:
   - yes
   - no

14. Would you find it acceptable for a developer to have an architect prepare working drawings, and then for the developer himself to manage the building and construction work on a development project?:
   - yes
   - no

15. When developing a property do you prefer to enter into a negotiated contract with a contractor of your choice?:
   - yes
   - no
   or do you prefer to go out on an open tender basis?:
   - yes
   - no
Appendix 3.

9.13. Incorrect measurement of the lettable area in the building

9.14. Poor quality construction and project supervision

9.15. Letting proceeding slower than anticipated

9.16. Budgeted rentals not being achieved

9.17. Uncertainty regarding the relationships between individual investors comprising a consortium owning a property development

9.18. Construction risk (e.g., works risk, delay, labour action, weather, materials shortages etc.)

9.19. Unforeseen building cost escalations

9.20. Failure to take out adequate insurance cover for the project

9.21. Any other risks which you believe should be ranked

10. In your opinion, who should be responsible for ensuring that the project is fully insured during the development phase before handover to the investor/purchaser?

- the investor
- the developer
- the building contractor
Appendix 3.

9. Please indicate in numbered order of priority (where 1 is the highest priority and 10 is the lowest priority) which of the following circumstances you believe comprise the top ten major risks inherent in the property development process:

9.1. securing the appropriate and desired rights for the site

9.2. the timing of the scheme within the property and economic cycles

9.3. inaccurate estimation of the end value of the scheme

9.4. inappropriate building design

9.5. an inability to find a buyer/investor for the scheme

9.6. an inability to find bridging finance to proceed with the scheme whilst looking for long term finance or an investor

9.7. problems with cash flow from the financier/investor to the developer

9.8. insolvency of the developer, financier/investor or the builder

9.9. inefficient tax structuring of the scheme

9.10. the implementation of penalty clauses and other controls such as rental guarantees and headleases

9.11. uncertainty regarding the terms of the transaction between the developer and the investor

9.12. overpayment of the developer in relation to the construction work completed
Appendix 3.

- sole proprietorship
- partnership
- other (please specify)

6. Which party do you believe is most protected by and benefits most from the negotiation and conclusion of a development agreement?:
   - developer
   - architect
   - investor
   - builder
   - the vendor of the site
   - other (please specify)

7. From the point of view of managing the risks inherent in the property development process do you believe that a written development agreement is:
   - absolutely essential
   - an expensive luxury
   - totally unnecessary

8. In property development schemes where your firm is involved, is a written property development agreement concluded:
   - always
   - sometimes (please indicate the approximate % of times such agreements are concluded)
Appendix 3.

- R1 million to R5 million
- R5 million to R10 million
- R10 million to R20 million
- R20 million to R50 million
- >R50 million
- other (please specify)

4. Assuming that the vendor of the land, the builder, developer, architect and investor/financier are all separate parties to a property development project, who do you understand the property development agreement to be transacted between?:

- the developer and the builder
- the architect and the developer
- the investor and the developer
- the builder and the investor
- the architect and the investor
- the land vendor and the investor
- another relationship (please specify):

5. When negotiating the acquisition or sale of a property development scheme, what is your preferred vehicle for holding the land?:

- private company
- close corporation
- shareblock company
- trust
Appendix 3.

QUESTIONNAIRE

in respect of

PROPERTY DEVELOPMENT AGREEMENTS

1. Name: ____________________________
   Company: ____________________________
   Position or function within company: ____________________________

   Primary business of company (please tick the appropriate box or boxes):
   • property development
   • construction
   • property investment and management
   • letting
   • other (please specify)

2. Type of property development schemes that your firm typically deals with (please tick the appropriate box or boxes and indicate that percentage of business which each type represents in the second column of boxes):

   • commercial (offices)
   • industrial
   • retail
   • residential

   %

3. What is the average minimum value of individual property development projects usually dealt with by your firm?:

   • <R1 million

   [ ]
Appendix 2.

In the interests of accuracy and in order to draw any meaningful conclusions, your answers need to be as honest and concise as possible.

Your assistance in this survey is greatly appreciated. All information will be held in the strictest confidence and none of the individual information supplied will be made available to the public.

I thank you for your co-operation.

Yours faithfully

AJ CALDER


SAPOA. The Development of Industrial and Office Parks with Special Reference to the Techniques Necessary for the Successful Structuring of such Property Developments in the South African Context, Papers Delivered at a Seminar on 31 August 1983

SAPOA. Property Development and Investment in the Eighties, Transcript of papers delivered at seminars on 26 February 1981

References and Bibliography


Erickson, C.A. Risk Sharing in Construction Contracts, Urbana: University of Illinois at Urbana Campaign, 1979 (Published PhD report).


Lester, M. Budget Review, AGENT (The official newsletter of the Estate Agents Board), No. 53, July 1994, pg. 7.
Appendix 3.

32.4. do you fix the operating costs at a prescribed amount escalating at a prescribed rate?:

- yes
- no

33. What rate do you use to calculate the notional return payable by a developer during the construction phase of a development project as the funds are being drawn down and before any tenants have begun paying rent?:

- a property related return
- the long bond rate
- a money market or 3 month NCD rate
- some other rate (please specify)

THE END

Please fax this completed questionnaire to

AJ CALDER
a/o University of the Witwatersrand
Department of Building

FAX No. (011) 339 8175

Thank you.
been handed over and the developer has been paid out his final draw, what sort of duration would you use for the notional lease forming the basis of the commission estimate?:

- 1 year
- 3 years
- 5 years
- other period (please specify)

32. When providing for the calculation of a "net return" required in terms of a rental guarantee or head lease,

32.1. do you specifically distinguish between and define those items that constitute capital costs and those that constitute income expenditure to be incurred in the maintenance of the buildings?:

- yes
- no

32.2. do you define in detail each specific operating cost item which will be deducted from the gross income and wait for the actual costs to be incurred before calculating the net income figure?:

- yes
- no

32.3. to whom do you allocate responsibility for selecting maintenance operators for functions such as security, cleaning, gardening, lift and escalator maintenance etc. when negotiating the terms of a development agreement?:

- developer
- Investor/buyer